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The Efficiency of Friendliness: Japanese Corporate Governance Succeeds again without Hostile Takeovers

Dan W. Puchniak

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The Efficiency of Friendliness: Japanese Corporate Governance Succeeds Again without Hostile Takeovers

Dan W. Puchniak†

Abstract: It is widely assumed that hostile takeovers are a prerequisite for an efficient system of corporate governance. This assumption is false.

Since the new millennium, Japan has transformed itself from being on the brink of one of the largest economic meltdowns in modern economic history to currently being in the midst of its longest period of postwar economic expansion (2002-2007). This astounding recovery was achieved without a single successful hostile takeover of a major Japanese company. True to its postwar tradition, corporate Japan has successfully restructured through government intervention, bank-driven reallocation of capital, and orchestrated and friendly mergers—the antitheses of the American corporate governance model, which is premised on hostile takeovers.

The conspicuous absence of hostile takeovers in Japan’s recent recovery is particularly remarkable considering that, during the recent recovery, market conditions for hostile takeovers were close to optimal. Almost all of Japan’s “idiosyncratic barriers” to hostile takeovers (i.e., stable shareholdings, a cultural aversion to hostile takeovers, and inefficient takeover laws) were ostensibly dismantled, and the bust-up values of a substantial percentage of Japan’s listed companies were considerably more than their cumulative stock price. To many experts, Japan appeared to be a utopia for hostile takeovers. Yet despite the pro-hostile takeover environment, there has never been a successful hostile takeover bid during Japan’s period of economic recovery. Japan’s unique system of corporate governance—lifetime employment and the influence of the government and banks—has fostered orchestrated and friendly (but not hostile) M&A as a significant force for restructuring. This is important because it provides evidence of “the efficiency of friendliness” in the era of globalization. Other countries can once again look to Japan’s unique system of corporate governance as a viable alternative to the American corporate governance model based on hostile takeovers.

† Assistant Professor in the Faculty of Law, National University of Singapore. The author would like to thank the Kyushu University LL.D. Program and the Japanese Government for supporting his research. Special thanks to Michiaki Abe, Caslav Pejovic, Mark Fenwick, Kenichi Osugi, Mitsuhiro Kamiya, Harald Baum, Kent Anderson, Leon Wolff, Luke Nottage, Tom Ginsburg, John O. Haley and Hyeok Joon Rho for providing comments on earlier drafts. To his wife, Norah, thank you for your thoughtful advice and for making the journey a remarkable experience.
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I. INTRODUCTION

Two decades ago, a love for hostile takeovers was largely limited to some American academics and highflying investment bankers on Wall Street who lived by the mantra "greed is good." Today, hostile takeovers are widely embraced by mainstream governments, academics, and corporate governance pundits around the world who assume that they are a prerequisite for an efficient system of corporate governance. This assumption is false.

1. WALL STREET (Twentieth Century Fox 1987). In the late 1980s, the catchphrase "greed is good" came to symbolize the corporate culture of Wall Street, which at the time was defined by hostile takeovers. The phrase was made famous in the Academy Award winning film "Wall Street." In the movie, the villain, Gordon Gekko, portrayed by Michael Douglas, makes a famous speech in which he proclaims "greed...is good." Id. Gekko's character, which was loosely based on the real-life American takeover mogul Carl Icahn, developed a popular following among Wall Street investment bankers. "Since the 1970s, [American] academics have pointed to the market for corporate control as the mechanism best suited to minimize the costs of the separation between owners and managers." Douglas G. Baird & Robert K. Rasmussen, Private Debt and the Missing Lever of Corporate Governance, 154 U. PA. L. REV. 1209, 1223 (2006). However, until more recently, especially in the 1980s, the view of hostile takeovers outside of the U.S. was largely extremely negative. In 1988, the CEO of Deutsche Bank, speaking from a German perspective, called hostile takeovers "blunders of American capitalism." Ronald J. Gilson, The Missing Infrastructure, 2004 COLUM. BUS. L. REV. 21, 25-26 (citing Ernst-Ludwig Von Thadden, On the Efficiency of the Market for Corporate Control, 43 KYKLOS 635, 635 (1990)). Using a similar tone, in 1989, Francois Mitterand, the President of France, described hostile takeovers as, "gangsterism and the law of the strongest." Id. at 26 (citing the same).

2. According to Ronald Gilson, "while the 1980s takeover wave in the United States was viewed with horror outside the U.S. and U.K., international attitudes toward hostile takeovers have changed markedly in recent years." Gilson, supra note 1, at 25. In 2006, Mike Burkart and Fausto Panunzi, in their detailed overview of the literature on hostile takeovers, conclude that:

... hostile takeovers are a mechanism to discipline managers and thereby address problems raised by the separation of ownership and control. Indeed, a functioning takeover market is the most direct way to achieve control contestability, which many commentators consider an essential component of an effective governance system. In recent years, this view has also gained support among European regulators and politicians, as the discussions surrounding the European Takeover Directive show. In particular, the European Commission and its expert group sought to open up Europe for takeovers to promote restructuring. According to the Commission, Europe badly needs more restructuring if it wants to accomplish the goal, set forth in the 2000 Lisbon Declaration, to become the world’s most dynamic economic region.

Mike Burkart & Fausto Panunzi, Takeovers 2-3 (European Corporate Governance Institute, Finance Working Paper No. 118/2006), available at http://ssm.com/abstract_id=884080. Similarly, in 2003, Marco Becht, a well-respected European academic and a sophisticated observer of European corporate governance, described the necessity for hostile takeovers in Europe as follows: "A European market for corporate control is seen as an integral part of a single capital market and a major driver of European competitiveness, innovation and growth." Marco Becht, Reciprocity in Takeovers 11 (European Corporate Governance Inst., Law Working Paper No. 14/2003), available at http://ssm.com/abstract=463003. The increasing consensus that hostile takeovers are a necessary mechanism for an efficient system of corporate governance appears to be based on the view that a central reason that the United States became the sole global economic superpower in the 1990s was because of its hostile takeovers driven restructuring in the 1980s. According to Holmstrom & Kaplan,
Recent economic history suggests that hostile takeovers are anything but a prerequisite for an efficient system of corporate governance. Japan’s miraculous rise from its postwar ruins to the world’s second-largest economy was built on a system of corporate governance that thrived because of—not despite—the absence of hostile takeovers. This historical fact is well-known and widely accepted. Based on this alone, the assumption that hostile takeovers are a prerequisite for efficient corporate governance appears ahistorical and misguided.

However, with the burst of the bubble in the early 1990s and the “lost decade” of economic ruin that followed, the Japanese corporate governance model was widely viewed as a failed economic experiment. Its success without two of the leading American M&A experts:

... when large-scale hostile takeovers appeared in the 1980s, many voiced the opinion that they were driven by investor greed; the robber barons of Wall Street had returned to raid innocent corporations. Today, it is widely accepted that the takeovers of the 1980s had a beneficial effect on the corporate sector and that efficiency gains, rather than redistribution from stakeholders to shareholders, explained why they appeared.

hostile takeovers was deemed irrelevant. Concurrently, in the 1990s, America’s unprecedented accumulation of wealth propelled it to the position of the world’s sole economic superpower. America’s success was largely attributed to its unique market-based corporate governance model, which was purportedly driven by hostile takeovers. Global competition led governments around the world to “play catch-up” by developing their own hostile takeover regimes. The increasing prevalence of hostile takeovers throughout the developed world, especially in continental Europe, became “evidence” of their efficiency and necessity. The received wisdom became that countries either embrace a hostile takeovers regime (in some form) or accept suboptimal economic performance.


6. Hansmann & Kraakman, supra note 2, at 447.

7. Even long after the successful restructuring in the United States, which was widely viewed as being driven by hostile takeovers, the mechanism of hostile takeovers continued to be viewed as the centerpiece of the American corporate governance model. See Coates, supra note 2, at 850-51; Coffee, supra note 2, at 20. See generally Baird & Rasmussen, supra note 1, at 1223; Roe, supra note 2, at 558.

8. The most prominent example of governments attempting to “catch-up” to the United States by implementing a hostile takeovers regime occurred in the early 2000s in the European Union. In 2001, the movement in the European Union towards implementing a hostile takeovers regime culminated in the Thirteenth Directive on hostile takeovers being put before the European Parliament. Although the directive was voted down by a tie vote, the European Union pushed forward in its attempt to create a wide hostile takeovers regime out of the belief that it had to do so to remain competitive with the United States and other developed countries. See Burkart & Panunzi, supra note 2, at 2-3; Gilson, supra note 1, at 25-30; When Battles Commence, ECONOMIST, Feb. 21, 2004 [hereinafter ECONOMIST Feb. 21, 2004].


10. This was clearly exemplified by a number of commentators who saw Japan’s resistance to implementing a hostile takeovers regime as a prominent cause for its continuing recession during the lost decade. According to Gilson, “The combination of crossholdings, bank holdings and governmental stasis that has frozen Japanese corporate governance leaves hostile takeovers as one of the few external mechanisms for systemic change that existing institutions do not block or at least greatly impede.” Gilson, supra note 1, at 24-25, 28. With respect to the EU accepting the necessity of hostile takeovers, Gilson states, “the market for corporate control is an equilibrating process that reallocates ownership of assets following a change in technology to the entity that then values them most highly. Hostile
It is in this context that Japan’s recent economic recovery provides a poignant counterexample. In the last decade, Japan has transformed itself from being on the brink of one of the largest economic meltdowns in modern economic history to currently being in the midst of its longest period of postwar economic expansion (2002-2007). This astounding recovery was defined by massive reallocations of capital from inefficient firms and industries to more efficient ones. If one accepts that hostile takeovers are an essential mechanism for an efficient system of corporate governance—particularly in periods of restructuring—then one would expect that hostile takeovers played a major role in Japan’s remarkable recovery.

However, this was not the case. In fact, their role was minimal. There was not a single successful hostile takeover of a major Japanese company during the recent recovery. Instead, true to its postwar tradition, corporate Japan takeovers play a special role in this equilibration . . . . From this perspective, the change in European attitudes toward hostile takeovers is understandable.” Id. at 28-29.


Milhaupt, in his review of the most widely reported hostile takeover attempts in Japan from 2000 to 2005, concludes, “the number of unsolicited bids is still very low by any measure and no bid thus far has been an unqualified success.” Milhaupt, supra note 2, at 2184. Abegglen, in his extensive review of the restructuring that drove recent recovery, finds that “even with the sharp decline in cross-shareholding there have not yet been any hostile takeovers.” ABEGGLEN, supra note 5, at 107. All of the above commentators are correct in their conclusion that there has not been a successful hostile takeover of a major Japanese company during the recent recovery. Also, it is correct that there has not been a successful hostile takeover bid involving any Japanese company (large or small) during the entire postwar period. However, in 2004, a group of investors led by Banners Co., acquired a fifty-five percent stake in Miyairi Valve to oust the incumbent president and replace him with a president designated by the investment group. 2005 CORPORATE VALUE REPORT, supra note 8, at 22; Hostility, of Sorts, ECONOMIST, Dec. 22, 2007 [hereinafter ECONOMIST Dec. 22, 2007]. First, it should be noted that this was a successful proxy contest and the investment group acquired its shares on the market (i.e., it was not a hostile takeover bid). See 2005 CORPORATE VALUE REPORT, supra note 8, at 22; Kenichi Osugi, What is Converging? Rules on Hostile Takeovers in Japan and the Convergence Debate, 9 ASIAN-PAC. L. & POL’Y J. 143, 150-151 (2007). Second, Miyairi Valve is a small listed company on the Second Section of the Tokyo Stock Exchange (i.e., this did not involve a major Japanese company). ECONOMIST Dec. 22, 2007. Third, the circumstances surrounding the proxy contest were so unusual that it was not precedent-setting. See 2005 CORPORATE VALUE REPORT, supra note 8, at 31; ECONOMIST Dec. 22, 2007. Due to these factors, most leading academic commentators, even those who claim that hostile takeovers became a significant factor during the recent recovery, do not even cite this case. In the few places that it is cited, it is not extensively dealt with and/or it is dismissed as insignificant. STEPHEN DEANE, POISON PILLS IN FRANCE, JAPAN, THE U.S. AND CANADA. ISS REPORT 8 (2007), available at http://www.issproxy.com/pdf/PoisonPillPrimer.pdf; ECONOMIST Dec. 22, 2007. Therefore, the conclusion that there was not a successful hostile takeover of a major Japanese company during the recent recovery is taken in this paper.

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successfully restructured through government intervention, bank-driven reallocation of capital, and orchestrated, friendly mergers—the antitheses of the American corporate governance model premised on hostile takeovers.13

The conspicuous absence of hostile takeovers in Japan’s recent recovery is even more remarkable considering that, in the opinion of most experts, market conditions for hostile takeovers during the recent recovery were close to optimal.14 Prior to and during the recovery, the bust-up values of a substantial percentage of Japan’s listed companies were considerably more than their cumulative stock price.15 Stable shareholdings between firms, which were widely viewed as the most significant barrier to hostile takeovers in Japan, had substantially declined to levels that many claimed made them increasingly irrelevant.16 Shareholder activism, spurred on by charismatic cultural icons and buttressed by a substantial increase in foreign shareholders, led many to suggest that Japan’s purported cultural aversion to hostile takeovers was no longer a major hindrance.17 Reforms to Japan’s corporate law essentially made Delaware takeover jurisprudence part of Japan’s legal framework.18 Indeed, many corporate governance experts considered Japan to be a utopia for hostile takeovers.19 Yet despite the pro-hostile takeover environment that emerged, there has never been a successful hostile takeover bid during Japan’s period of economic recovery.20

Ironically, not only were successful hostile takeovers absent during Japan’s recent recovery, but the recovery appears to have reinforced the traditional

13. For an overview of how the American model of corporate governance has been defined in the literature, see Dan W. Puchniak, The Japanization of American Corporate Governance? Evidence of the Never-Ending History for Corporate Law, 9 ASIAN-PAC. L. & POL’Y J. 7 (2007).


15. See The Battle for Corporate Control: The Outlook for M&A in Japan, ECONOMIST INTELLIGENCE UNIT 20 (2005) [hereinafter EIU 2005]; see also Milhaupt & West, supra note 3, at 28; Ever So Polite, ECONOMIST, Feb. 17, 2001 [hereinafter ECONOMIST Feb. 17, 2001]. In this article, “bust-up value” refers to the total value of a company’s assets upon liquidation.


18. Milhaupt, supra note 2, at 2173-74.

19. Turner, supra note 14. See generally Milhaupt, supra note 2, at 2189. Even during the lost decade, foreigners have been very bullish on the inevitable rise of hostile takeovers in Japan. See also Say “Hostile Takeover” in Japanese, ECONOMIST, July 19, 1997, at 65 [hereinafter ECONOMIST July 19, 1997].

20. See supra note 12.
Japanese corporate governance model (in which hostile takeovers play no role). Despite the poison pill being made legally available, banks and companies have opted to rebuild substantially their cross-shareholdings over the last two years. Shareholder activism has been quelled by the prosecution and demise of Horie and Murakami—the two de facto leaders of the recent shareholder activism movement. The “more efficient” board structure found in the United States, with its mandatory “independent” directors, has been adopted by less than three percent of Japan’s listed companies since it was made legally optional in 2002, and the rate of companies choosing to adopt it has dramatically slowed since then. These facts clearly demonstrate that the recent recovery inspired a movement away from, not towards, the American governance model based on hostile takeovers.

A striking example of the limited effect of hostile takeovers on Japan’s recent recovery can be seen in the failed hostile takeover bid by Oji Paper for Hokuetsu in 2006, which was the first postwar hostile takeover bid by one “blue chip” Japanese company for another. When Oji made its hostile bid (and even after the bid failed), numerous commentators regarded it as an “epoch-making” event that illustrated the increasing significance of hostile takeovers in Japan.

In fact, the opposite is true. Oji’s bid offered target shareholders a handsome premium and was widely regarded as making “good business sense.” As with previous hostile bids, it predictably failed when stable friendly shareholders protected incumbent management. Despite numerous

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21. See Yujiro Taki et al., Options Available for Japanese Companies in a Globalized Market Environment 5-7 (NRI Papers No. 111 2006), available at http://www.nri.co.jp/english/opinion/papers/2006/pdf/nri2006111.pdf; Yo Makino, Cross-shareholding must be put under control, NIKKEI WKLY., Oct. 16, 2006; Cross-holding Revives as Takeover Shield, NIKKEI WKLY., Jan. 29, 2007 [hereinafter NIKKEI Jan. 29, 2007]. As defined by Gilson, the “poison pill” is “a device that, whatever its particular form, functions to substantially dilute a hostile bidder’s holdings if the bidder’s holdings exceed a triggering percentage.” Gilson, supra note 1, at 29.


23. “As of 2006, 110 out of Japan’s approximately 4,000 listed companies have adopted an American-style board. Seventy-one companies moved to the committee-system in the first round of adoptions in 2003. As of October 2006, another 39 companies have adopted the committee-system.” Peter Lawley, Panacea or Placebo? An Empirical Analysis of the Effect of the Japanese Committee System Corporate Governance Law Reform, 9 ASIAN-PAC. L. & POL’Y J. 105, 112 (2007); see Alford, supra note 22; Osugi, supra note 12, at 158.


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unscrupulous defensive tactics by Hokuetsu and its stable friendly shareholders, which would have sparked a tirade of litigation in almost any other developed country, not a whisper was heard in a Japanese courtroom. Hokuetsu is a company in which foreigners control twenty-five percent of the shares. Yet, in traditional postwar style, incumbent management and employees, with help from stable friendly shareholders, rolled over nascent “shareholder activists” without breaking a sweat.

The conclusion that hostile takeovers played a minimal role in Japan’s recent recovery will likely surprise both casual observers and Japan experts. This is because for two decades, a hopeful cadre of journalists, academics, lawyers, and M&A consultants has produced a veritable library of literature explaining why Japan has been on the brink of a vigorous hostile takeovers market similar to that in the United States. Recently, a number of luminaries in the field have even drawn strained comparisons between the de minimus effect that repeated failed attempted hostile takeovers have had on Japan’s recent recovery with the dramatic effect that the vigorous hostile takeovers market had on restructuring corporate America in the late 1980s. The myopic focus on predicting the arrival of hostile takeovers in Japan and straining to find comparisons with the evolution of American corporate governance has obscured the more important reality that “friendly change” (i.e., friendly and orchestrated M&A, government intervention, and bank reallocation of capital) has driven Japan’s remarkable recovery.

Despite talk of a convergence to an American system of market-based corporate governance, Japan’s recent recovery (indeed its entire system of postwar corporate governance) cannot be understood through the narrow lens of the American corporate governance model. Japan’s approach to M&A has evolved, but not in the way predicted by past experiences in the United States. Unique traits of Japanese corporate governance—particularly lifetime employment and the powerful influence of the government and banks—have led to orchestrated and friendly (but, not hostile) M&A being the significant force for restructuring. This is not new. Hostile takeovers have played a minimal role throughout Japan’s successful postwar economy. What is new is

28. Alford, supra note 22.
30. As Milhaupt writes: “The parallels with Delaware in the 1980s are striking. In both systems, market and legal changes reverberated through the political economy, transforming existing corporate governance institutions and catalyzing further development of the corporate law.” Milhaupt, supra note 2, at 2176, 2189; see also Hines et al., supra note 22, at 360; Jacobs, supra note 14, at 327.
31. Milhaupt, supra note 3, at 2089; Milhaupt & West, supra note 3, at 6; see also KESTER, supra note 3, at 5, 54; Aoki, supra note 4, at 139; Aoki et al., supra note 3, at 4-5, 46-47; Sheard, supra note 3.
evidence that in the era of globalization, the "efficiency of friendliness" exemplified by Japanese corporate governance is still an effective mechanism for efficiently restructuring a developed economy. This is important because it once again makes Japan's unique approach to corporate governance a viable alternative to the American corporate governance model based on hostile takeovers.

The balance of this paper will proceed as follows. First, section two will examine how Japan's traditional main bank model prospered in the absence of hostile takeovers and explain why academics and other commentators have ignored this evidence of "success without hostile takeovers." Section three will then present evidence of the monumental economic restructuring that occurred prior to and during Japan's recent recovery (1997-2006) and analyzes why, according to conventional wisdom, this restructuring should have been (but was not) marked by a wave of hostile takeovers. Section four will explore the history of failed hostile takeovers during the recent recovery and challenge arguments that these failed hostile takeovers have played a significant role in Japan's recent recovery. The conclusion reached in this section is that failed hostile takeover attempts played a marginal role in Japan's recent recovery. Section five will provide a brief explanation of how traditional barriers to hostile takeovers in Japan appear to be rebuilding and why the recent recovery appears to have inspired a movement away from, not towards, the American governance model. Section six will set out the valuable lessons learned from Japan's "friendly" recovery.

II. The Traditional Japanese Main Bank Model

A. Postwar Japanese Corporate Governance—Efficiency without Hostile Takeovers

From the postwar period until the burst of the bubble, Japan's economic performance was exceptional. In three short decades, Japan managed to rise from a country decimated by a world war to arguably the wealthiest nation on earth (as measured by per capita GNP and net holdings of foreign assets). In 1988, the Japanese economy was nine times larger than in 1955; by comparison, the United States' economy had grown about 2.5 times in the same period. Japan's rise to the pinnacle of economic development was achieved with year after year of extraordinary economic growth. From 1950 to 1973, during the "high growth era," Japan's real GNP growth rate (GNP growth adjusted for inflation) averaged more than ten percent per year. The efficiency

33. Id. at 3.
34. Id.
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of corporate Japan was also phenomenal with an annual growth rate per work-hour more than double that of the United States throughout the 1970s.\textsuperscript{35}

In the 1980s, as a result of Japan’s seemingly unstoppable economic gains, fear developed in the United States that Japan might overtake it as the world’s preeminent economic power.\textsuperscript{36} This inspired a flurry of literature devoted to unraveling the factors behind Japan’s economic success.\textsuperscript{37} A broad consensus emerged that Japan’s unique form of corporate governance, known as the main bank model, was a driving force behind its economic growth and a significant contributor to its competitive advantage over the United States.\textsuperscript{38}

Contrary to popular belief, Japan’s main bank model was not marked by an absence of M&A. During the 1950s, there were approximately 500 M&A transactions per year and, by 1985, the number had increased to approximately 2,000 per year.\textsuperscript{39} In fact, for most of the 1980s, when America was experiencing an M&A boom, the rate of combinations per 10,000 companies was higher in Japan than in the United States.\textsuperscript{40}

The oddity of the highly successful Japanese main bank model, especially when compared with the American model, was its lack of hostile takeovers. All of the large-scale mergers and acquisitions in postwar Japan were either friendly or orchestrated by the government.\textsuperscript{41} In Japan’s friendly corporate environment, legislation governing takeover bids did not even exist until the 1971 \textit{Securities and Exchange Act}—under which there were only two friendly takeover bids registered and concluded prior to its amendment in 1990.\textsuperscript{42}

\textsuperscript{35} WILLIAM J. BAUMOL ET AL., PRODUCTIVITY AND AMERICAN LEADERSHIP 88 (1989).
\textsuperscript{36} See ITO, supra note 32, at 365-67.
\textsuperscript{38} See ITO, supra note 32, at 369; Porter, supra note 37; see also Romano, supra note 37, at 297-313.
\textsuperscript{39} KESTER, supra note 3, at 8 n.1, 83.
\textsuperscript{40} Id. at 83.
\textsuperscript{41} According to Kester, in the postwar period until the burst of the bubble in 1990, the large-scale mergers that did occur were friendly deals that were sanctioned by the government and/or main banks and between related companies. The purpose of the mergers was normally a “deliberate attempt to alter the structure and performance of the industries in which the mergers occurred.” Id. at 94. In most cases, the government and main banks orchestrated the mergers to: (1) reduce excess capacity; (2) avoid destructive price competition; (3) build domestic firms to the scale that they can compete internationally; and/or (4) combine weaker firms with stronger ones. Id.
\textsuperscript{42} Id. at 99.
This stood in stark contrast to the American corporate governance model which was widely seen as being driven by hostile takeovers. In the 1980s, hostile bids were received by over half of all major American companies and viewed as the central mechanism for controlling agency costs and driving America’s successful restructuring.\textsuperscript{43} In 1988 alone, there were 85 successful hostile takeovers of large listed companies in the United States.\textsuperscript{44} The obvious question, especially for American academics, became: How did Japan engineer the world’s most efficient economy without hostile takeovers?

B. The Main Bank Model Obviated the Need for Hostile Takeovers

Prior to the burst of the bubble, the answer was simple: Japan did not have hostile takeovers because it did not need them.\textsuperscript{45} The main bank model provided a more efficient system for controlling agency costs and driving efficient restructuring, which are considered the two essential benefits of hostile takeovers. The details of how the main bank model provided an efficient substitute for hostile takeovers can be seen by examining its three fundamental elements: (1) main banks; (2) keiretsu; and (3) lifetime employment.

As the name suggests, at the core of Japan’s main bank model was its heavily regulated and quasi-government-controlled banking industry (not its financial markets). Although Japanese companies borrowed from many banks, most companies had a special relationship with only one: their main bank.\textsuperscript{46} Typically, main banks held the major payment settlement accounts, and were both the largest single lenders and the principal shareholders of the company.\textsuperscript{47} This made main banks the central repository of accurate real time information about corporations’ financial health and business ventures.\textsuperscript{48} Another key facet to main banks’ relationships with their company clients was that main banks made an implicit promise to restructure failing corporations in times of financial or managerial crisis, rather than foreclosing on their loans—a promise made feasible because of the government’s implied promise to prevent main

\begin{footnotes}
\item[43.] Holmstrom & Kaplan, supra note 2, at 125.
\item[45.] According to Kester, the Japanese system of corporate governance “largely obviated the necessity for a deeper and active market for corporate control at home and limited the activity of Japanese companies in the market abroad and yielded a paucity of attractive targets for foreign bidders.” KESTER, supra note 3, at 5; see also Milhaupt & West, supra note 3, at 6.
\item[46.] MasaHiko Aoki, Information, Corporate Governance, and Institutional Diversity 60-94 (2000).
\item[47.] See also Dan W. Puchniak, \textit{The 2002 Reform of the Management of Large Corporations in Japan}, 5 \textit{Australian J. Asian L.} 42, 46 (2003); Aoki et al., supra note 3, at 2-15; Milhaupt, supra note 3, at 2087-88.
\end{footnotes}
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bank failure.49

Prior to the burst of the bubble, this long-term intimate relationship between main banks and client companies was seen as the zenith of efficiency.50 Having ready access to a wealth of accurate information about client corporations allowed these main banks to evaluate managerial performance effectively.51 Further, main banks' substantial debt and equity positions with client companies gave them the leverage to use their information to influence managerial decisions and, when necessary, to control agency costs by replacing senior management and placing members of the bank on company boards.52 The main bank's promise to attempt to restructure underperforming clients allowed companies to pursue long-term goals and invest in human capital, which was a central component of Japan's competitive advantage over the United States during Japan's high growth era (1950-1973).

In addition, main bank monitoring avoided many of the deficiencies in the hostile takeovers-based American corporate governance model. Main banks did not suffer from the same collective action and information asymmetry problems as dispersed shareholders and, unlike hostile takeovers, did not force managers to focus myopically on short-term quarterly profits.53 The main bank's promise to help restructure failing client firms also prevented valuable firm-specific assets from being squandered by premature liquidation and avoided the significant costs associated with formal bankruptcy.54

Keiretsu and stable shareholdings were the second fundamental element of the main bank model that provided an efficient substitute for hostile takeovers.55 Keiretsu is the name given essentially to the six major corporate

49. See Milhaupt, supra note 3, at 2088-89; Dan W. Puchniak, Perverse Main Bank Rescue in the Lost Decade: Proof that Unique Institutional Incentives Drive Japanese Corporate Governance, 16 PAC. RIM L. & POL'Y 13, 20-24 (2007); Puchniak, supra note 47, at 46; Paul Sheard, Main Banks and the Governance of Financial Distress, THE JAPANESE MAIN BANK SYSTEM, 210-11 (Masahiko Aoki & Hugh Patrick eds., 1994). Under the American model, the court-led bankruptcy system and the market for corporate control are seen to play the same role as main bank rescue. It is argued that in its heyday, main bank monitoring did this more effectively than the American system and was a factor that contributed to Japan's higher growth. According to main bank theory, the main bank is in the optimal position to rescue because it does not suffer from collective action and information asymmetry problems suffered by creditors, managers, and shareholders, and is less costly and has better information than the courts or corporate raiders. Id. at 210-11.

50. See Puchniak, supra note 47, at 46.


52. See Puchniak, supra note 49, at 22-23; Puchniak, supra note 47, at 46; see also ITO, supra note 32, at 116; AOKI, supra note 46, at 71; Aoki et al., supra note 3, at 25-26; Sheard, supra note 49, at 193, 211; Gilson, supra note 48, at 210.

53. See Puchniak, supra note 47, at 46; see also Coffee, supra note 2, at 648-49; Gilson, supra note 48, at 211-12; Milhaupt, supra note 51, at 19-21.


groups in Japan, composed almost entirely of Japan's "blue chip" companies. These corporate groups were highly interconnected, not only by interlocking or cross-shareholding, but also by reciprocal directors, product market exchanges, information exchanges and a shared central main bank. In the postwar period, at the high point of this form of corporate organization, approximately two-thirds of all company shares in Japan were held by stable corporate shareholders friendly to management.

Keiretsu specifically, and stable shareholding relationships more generally, buttressed the stability and long-term managerial focus that main banks bestowed upon their company clients. This was because stable shareholdings eliminated the threat of hostile takeovers—allowing managers to focus on long-term investments, bolster human capital and ensure themselves and fellow employees long-term employment. This made white-collar and blue-collar employees quasi-owners of the firm, which was an extremely effective way to minimize the agency costs that hostile takeovers are said to address in the American model. In addition, the keiretsu corporate structure (by allowing information and market exchanges between firms) made it possible for companies to capture many of the synergetic efficiency gains of hostile takeovers, without the significant costs associated with the complete integration of companies after a hostile takeover.

Lifetime employment was the third fundamental element of the main bank model that eliminated the need for hostile takeovers. Lifetime employment existed in most large firms and covered white-collar, as well as most blue-collar, employees. The lifetime employment system involved an implicit promise from the employer to the employee of employment until the age of retirement. Japanese corporations could credibly make this promise because main banks and stable shareholders largely protected companies from hostile takeovers and helped them restructure in times of financial crisis. In return, employees gave an implicit promise not to abandon the company, reinforced by


57. See Gilson, supra note 48, at 208; Milhaupt, supra note 51, at 25.

58. See Gilson, supra note 48, at 208-09; Shishido, supra note 55, at 210-12.

59. Milhaupt, supra note 51, at 29-31; see also Coffee, supra note 2, at 648-49; Gilson, supra note 48, at 203-04.

60. Coffee, supra note 2, at 648-49; Gilson, supra note 48, at 206-08, 211-12; Milhaupt, supra note 51, at 19-21.


62. Milhaupt, supra note 3, at 2092-95; Shishido, supra note 55, at 203-04.

63. Milhaupt, supra note 3, at 2092-95; Puchniak, supra note 47, at 47; Shishido, supra note 55, at 203-04.
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...a non-existent external labor market and a "top heavy" compensation system based on seniority.64 The result of lifetime employment was that the survival of the company was intrinsically tied to the economic fortunes of executives and employees—the ultimate incentive for minimizing agency costs and resisting hostile takeovers.

In sum, the three fundamental elements of the main bank model acted as a self-reinforcing web of governance mechanisms that minimized agency costs and ensured that capital was efficiently allocated throughout the economy. As such, the main bank model was widely viewed as making hostile takeovers unnecessary because it performed the same functions as hostile takeovers, but more efficiently. Indeed, most experts posited that introducing hostile takeovers into postwar Japan would have broken the web of "friendly efficiency" that allowed its economy to consistently outperform all others for three consecutive decades.65

C. The Flawed Rationale for Discarding the Success of the Main Bank Model

In 1990, after more than three decades of economic bliss, Japan's celebrated main bank model came crashing down with the bursts of the stock market and real estate bubbles. On the last day of business in 1989, the Nikkei 225 stock price index reached its 38,915 peak and then collapsed. By October 1, 1990, the Nikkei hovered barely above 20,000, which was a decline of almost fifty percent in nine months. A rebound in stock prices never occurred. For the balance of the 1990s, which came to be known as the "lost decade," the Nikkei average floated around 15,000.66 It entered the new millennium with a brief climb up to 20,000 and then plummeted again to its postwar low of 7,607 on April 28, 2003, which was less than twenty percent of its bubble peak.67

The burst of the real estate bubble followed on the heels of the stock market decline. At the end of the 1980s, Japanese real estate had reached astronomical heights. The value of the grounds of the Imperial Palace in Tokyo was said to be equal to that of California and the total value of land in Japan was three times that of the United States (despite Japan being about four percent the size).68 Land prices began to fall dramatically in late 1991, and, by 1995, prices were half of their peak values. They continued to decline throughout the lost

64. Milhaupt, supra note 3, at 2092-95; Shishido, supra note 55, at 203-04.
65. Aoki, supra note 4, at 139; Porter, supra note 37.
67. See Hutchison et al., supra note 66.
68. ITO, supra note 32, at 5.
The burst of the stock market and real estate bubbles had a devastating impact on the entire Japanese economy. During the lost decade, the economy slipped into negative growth, and price deflation placed a strangle hold on domestic investment and spending. Unemployment increased to postwar highs. The famed Japanese banking system amassed mountains of non-performing loans (NPLs) and had capital ratios that were on the verge of falling below the regulatory minimums required to keep their doors from closing.

The entire banking system would have likely fallen into complete chaos if not for the Japanese government's forced mergers and bailouts. The government's role as the backstop for failing banks and its pump-priming spending resulted in massive deficits that were unmatched by any other developed country. During the darkest days of the lost decade (e.g., the banking crisis in 1997), questions arose as to whether Japan's position as one of the world's leading economies might quickly slip away. In this context, it is understandable why so many experts found it convenient to write off the main bank model as a failed economic experiment.

However, Japan's economy has since recovered and is in the midst of its longest period of sustained postwar economic expansion (2002-2007). This makes it easier to place the lost decade in its proper perspective. In hindsight, even in the darkest days of the lost decade, Japan maintained a firm grip on its position as the world’s second-largest economy and numerous Japanese companies continued to be global leaders in their industries. The lost decade did not cause panic or social instability in Japan. Most importantly, the lost decade did not alter Japan's position as one of the world’s preeminent economies—which was achieved as a direct result of the three decades of miraculous economic growth under the main bank model.

Thus, even in the shadow of the lost decade, there is no basis for concluding that the Japanese main bank model is fundamentally flawed. To the contrary, the main bank model allowed Japan to make the transition from a

71. See id.
73. VOGEL, supra note 5, at 27; Miyake, supra note 11.
74. ABEGGLEN, supra note 5, at 131; VOGEL, supra note 5, at 1-2, 205; Gilson, supra note 5, at 331; Miwa & Ramseyer, supra note 5, at 409; Milhaupt, supra note 5, at 428.
76. But see ECONOMIST July 22, 2006, supra note 66.
77. ABEGGLEN, supra note 5, at 1-3.
country in economic ruin to a leading world economy in a short period of time—an accomplishment that many developing countries would undoubtedly like to replicate. In this light, the main bank model serves as weighty evidence that hostile takeovers are unnecessary for an efficient system of corporate governance, especially in the early and transitional stages of economic development.

D. Evidence of the “Efficiency of Friendliness” in the Era of Globalization

Although Japan’s pre-bubble economic success provides convincing evidence of efficient corporate governance without hostile takeovers, it suffers from two weaknesses. First, several scholars posit that there is a fundamental difference between corporate governance in developing and developed economies. The argument is that, although the main bank model may have been efficient for Japan when it was “catching up” to other developed countries, the threat of hostile takeovers is necessary if Japan (or any other developed country) wants to maintain its competitiveness as a developed economy.

Second, several scholars point to the increasing level of globalization, which started in the late 1980s, as uniquely affecting the sustainability of domestic systems of corporate governance. They assert that it was not until globalization that a true international competition emerged in which systems of corporate governance could compete on a global scale. This suggests that although the main bank model may have been a sustainable (albeit suboptimal) system of postwar corporate governance, it cannot exist post-globalization, where it is forced to compete head-to-head with the “optimally efficient” American model. In the same vein, some suggest that the American model did not crystallize until the late 1980s. Therefore, even if Japan may have had a postwar competitive advantage over America, this does not necessarily mean that the main bank model’s “friendly efficiency” can effectively compete

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78. According to James Abegglen, “Japan has moved from total defeat and utter poverty to great economic power and wealth in little more than 50 years. This success is without precedent in world history.” Id. at 7, 141.

79. See Gilson, supra note 48, at 216-220; Gregory Jackson & Hideaki Miyajima, Introduction, CORPORATE GOVERNANCE IN JAPAN 1, 8 (Masahiko Aoki et al. eds., 2007).

80. Milhaupt & West, supra note 3, at 3.


against the post-globalization hostile takeovers-based American model.\(^{83}\)

Japan’s recent recovery provides valuable evidence that effectively responds to both of these arguments. It demonstrates that Japanese corporate governance, focusing on lifetime employment, government intervention, bank reallocation of capital, and orchestrated and friendly M&A (without hostile takeovers) can be an extremely effective form of corporate governance for developed economies in the post-globalization era. Japan’s recent recovery also provides further evidence for developing and transitional economies of the long-term efficiency of Japan’s “friendly” government-controlled system of corporate governance.

III. JAPAN’S REMARKABLE, YET FRIENDLY, RECOVERY

A. Japan Has Finished Recovering and Entered a Period of Sustainable Growth

Japan’s recent economic recovery has been remarkable. It has propelled Japan, which appeared to be on the brink of economic collapse at the end of the 1990s, to being in the midst of its longest period of sustained postwar economic expansion.\(^{84}\) At the end of the first quarter in 2007, the Japanese economy had expanded for sixty-four straight months since February 2002—well surpassing the length of the second longest postwar economic expansion period during the famed Izanagi boom (November 1965 to July 1970).\(^{85}\) During this time, corporate profits hit record highs after consecutively increasing for nineteen quarters, which was another postwar record.\(^{86}\)

Japanese banks, which were crippled during the lost decade by NPLs and eroded capital, have recovered and recently logged record profits.\(^{87}\) All of the major banks have repaid the government loans that they received during the lost decade and have strengthened their required capital ratios to comfortable levels.\(^{88}\) The major banks have also ridded themselves of the mountains of NPLs that threatened their stability throughout the lost decade. When NPLs peaked in March 2002, the NPLs ratio of major banks was astronomically high at 8.7 percent.\(^{89}\) In March 2006, the NPLs ratio had sunk to a low of 1.8

83. Hansmann & Kraakman, supra note 2, at 447.
84. See Miyake, supra note 11; JEN June 4, 2007, supra note 11.
85. JEN June 4, 2007, supra note 11.
86. Id.
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percent—far surpassing the government’s goal of cutting the NPLs ratio to 4.35 percent.\textsuperscript{90}

Stock market and real estate prices, the decline of which marked the beginning of the lost decade, have substantially rebounded. In the first quarter of 2007, the Nikkei 225 stock index, as a result of gains throughout the recovery, hovered around 18,000—more than double its 2002 year-end level.\textsuperscript{91} During this market rally, Japanese banks and corporations had become net purchasers of stocks after more than a decade of sell-offs.\textsuperscript{92} In 2006, land prices began to rebound for the first time since the real estate bubble burst while larger metropolitan areas have recently experienced double-digit gains.\textsuperscript{93}

Strengthening of the job market is yet another indicia of the dramatic scope of this broad-based recovery. In 2006, for the first time since the burst of the bubble, there were more job openings than were applicants to fill them.\textsuperscript{94} In fact, in sharp contrast to the lost decade, over the last few years, companies have been scrambling to hire recent university graduates.\textsuperscript{95} In addition, since 2005, companies began hiring more permanent workers than those on a part-time basis, which is also a reversal of a trend that developed during the lost decade.\textsuperscript{96}

After almost five years of a record-breaking recovery, a consensus has emerged that “Japan’s economy has moved decidedly from restructuring to growth.”\textsuperscript{97} Some are even predicting that the new restructured corporate Japan will take another run at becoming the world’s preeminent economic superpower.\textsuperscript{98} Although the extent of Japan’s future economic success is debatable, it is clear that Japan’s “recovery” is over.\textsuperscript{99} Even if Japan’s economy were to dip into another recession today, the fact that Japan has recently

\textsuperscript{90} Id.
\textsuperscript{91} \textit{Nikkei Briefly Revisits 18,000 Level for 1st Time in 3 months}, JAPAN ECON. NEWswire, June 1, 2007.
\textsuperscript{92} See John Plender, \textit{An Accountability Gap is Holding Back Japan’s Economy}, FIN. TIMES, Mar. 15, 2007.
\textsuperscript{93} FT Aug. 25, 2007, supra note 66.
\textsuperscript{95} \textit{Over to You, Big Spender}, ECONOMIST, Apr. 21, 2007.
\textsuperscript{96} Id.
\textsuperscript{98} As Nottage notes, “[a] second reason for greater interest recently in Japanese corporate governance is that its vast economy—still many times larger than China’s, for example—seems finally to be pulling itself out of its ‘lost decade’ (and a half) of economic stagnation. Indeed, the author of ‘Japan: The System that Soured’ now argues that it will stun the world in its economic renaissance, albeit probably not for another decade—following a ‘tumultuous battle’ at the political level.” Luke Nottage, \textit{Nothing New in the (North) East? Interpreting the Rhetoric and Reality of Japanese Corporate Governance 2} (Sydney Law School Research Paper No. 06/2 2006) (citations omitted), available at SSRN: http://ssrn.com/abstract=885367.
experienced its longest period of postwar economic expansion is a historical fact that will not change. Indeed, many pundits mark July 14, 2006, when the Bank of Japan increased interest rates for the first time in almost seven years and ended its “free money” policy, as the definitive date that Japan finished its recovery. That was over a year ago, and Japan’s growth has continued. In fact, many predict Japan’s economic growth in 2007 will outpace that of the United States. The interesting question now is not whether Japan will recover (it has), but what exactly drove its remarkable recovery?

B. Japan’s Remarkable Recovery: Government and Bank-Driven Restructuring

A major factor behind Japan’s remarkable recovery has been the enormous economic restructuring that has taken place since 1997. Since that time, Japanese banks have reallocated huge sums of capital from inefficient to efficient corporations and government orchestrated and friendly mergers have forced efficient consolidation in Japan’s major industries. As to be expected from Japan’s postwar history, the role of hostile takeovers in the restructuring process has been de minimis. Instead, in time-honored tradition, the government and main banks determined the path that corporate Japan has followed.

The government’s reform of the main bank model by phasing out the “no fail” bank policy was one of the key components of the restructuring. The “no fail” bank policy, which existed throughout the postwar era until 1997, was an implicit promise by the government not to allow any bank to fail. The “no

100. See Michiyoe Nakamoto, Changing the Japanese Mindset, FIN. TIMES, Feb. 17, 2007; ECONOMIST July 22, 2006, supra note 66. James Abegglen, a leading expert on the Japanese economy who wrote about Japan’s remarkable recovery, concluded in October 2004 that:

the redesign of Japan’s companies and industry has now been largely accomplished. The economy is recovered as deflation ends and growth resumes. Japan’s companies are again the dynamic organizations that have made the economy great and the country rich. No less important, these necessary changes have been made while the basic values that shape Japan’s companies—the company as a social organization—have continued in place as well.

ABEGGLEN, supra note 5, at vii; see also Jackson & Miyajima, supra note 79, at 42.


102. According to Tsutomu Miyagawa, Professor of Economics at Gakushuin University and a faculty fellow at the Research Institute of Economy, Trade and Industry (RIETI), “Prospects finally began to brighten up in the period between 2002 and the present day, in which the economy began to recover. One of the factors behind this recovery is the massive restructuring that began in 1997.” Tsutomu Miyagawa, The Growth Potential of the Japanese Economy—the age of endogenous innovation, (RIETI Brainstorming 2006/5 2006), available at http://www.rieti.go.jp/en/papers/research-review/032.html.

103. As Milhaupt describes it, “no member of the banking industry was allowed to exit (fail), other than through merger with a stronger member.” For a detailed review of the “no fail” policy in postwar Japan until the late 1990s, see Curtis J. Milhaupt, Japan’s Experience With Deposit Insurance and Failing Banks: Implications for Financial Regulatory Design?, 77 WASHINGTON U. L. Q. 399, 410 (1999). For an analysis of how the government’s “no fail” policy continued even into the early 2000s, see Hoshi & Kashyap, supra note 66, at 17-19; Puchniak, supra note 49, at 42-59.
fail" policy shielded banks from market forces and allowed the government to control their activities through its regulatory incentives.\textsuperscript{104}

As explained above, prior to the burst of the bubble, the "no fail" bank policy was extremely efficient because it provided the necessary incentive for banks to restructure their underperforming client companies—avoiding the significant costs of premature liquidation and formal bankruptcy.\textsuperscript{105} The "no fail" policy also enhanced the stability of Japanese companies, allowing other important features of the main bank model (e.g., investment in human capital and a focus on long-term profitability) to prosper.\textsuperscript{106}

However, after the bubble burst, the government's "no fail" policy produced the opposite effect.\textsuperscript{107} The collapse of the stock and real estate markets dramatically impaired the regulatory capital of Japanese banks and saddled them with mountains of nonperforming loans.\textsuperscript{108} The Basel Accord, which came into force shortly after the bubble burst, required Japanese banks to maintain a certain level of regulatory capital or be shut down.\textsuperscript{109} This created the perverse incentive for banks to lend to their worst clients in order to make it appear as if banks had sufficient regulatory capital and that their nonperforming loans were in check.\textsuperscript{110}

The systematic lending to underperforming client companies, figuratively called "zombie firms," was carried out by the entire banking industry, on the largest possible scale, throughout the lost decade.\textsuperscript{111} The result was that the creative destruction of unprofitable firms that should have occurred following the burst of the bubbles did not—and new, more productive, firms were denied the necessary capital to grow.\textsuperscript{112}

At first blush, it seems that lending to zombie firms would not be a viable long-term strategy for Japanese banks. Indeed, free market forces should have quickly culled the banks that engaged in zombie lending, and their unproductive zombie clients, from the market.\textsuperscript{113} This is where the "no fail" policy loomed large. During the lost decade, the Japanese government used its forbearance "no fail" policy to insulate banks from the market forces that

\textsuperscript{104} See Aoki, supra note 46, at 69, 86; Aoki et al., supra note 3, at 26-32; Milhaupt, supra note 103, at 410-13; Sheard, supra note 49, at 204-10; Kazuo Ueda, Institutional and Regulatory Frameworks for the Main Bank System, THE JAPANESE MAIN BANK SYSTEM 89 (Masahiko Aoki & Hugh Patrick eds., 1994).
\textsuperscript{105} See Aoki et al., supra note 3, at 18; Puchniak, supra note 49, at 22-23; Sheard, supra note 49, at 190-91, 210-11.
\textsuperscript{106} See Milhaupt, supra note 103, at 411.
\textsuperscript{107} Puchniak, supra note 49.
\textsuperscript{108} Id. at 43-44.
\textsuperscript{109} See id.
\textsuperscript{110} See id. at 44-45.
\textsuperscript{111} See id. at 34-36.
\textsuperscript{112} See Puchniak, supra note 49.
\textsuperscript{113} See id. at 49.
should have quickly ended lending to zombie firms.\textsuperscript{114}

The government built a complex web of laws, regulations and administrative guidance to ensure that banks that supported zombies would not fail.\textsuperscript{115} Empirical evidence demonstrates that main banks (as opposed to other banks and non-bank lenders) were at the heart of this perverse lending system, as they played the largest role in zombie lending.\textsuperscript{116} The government's incentive to maintain the main bank zombie system was to avoid the immediate economic and political ramifications of allowing large-scale bank and business failures.\textsuperscript{117} Where the government had used laws, regulations and administrative guidance to propel growth prior to the burst of the bubble, in the lost decade, it used laws to support zombie lending and keep inefficient companies from failing.\textsuperscript{118} In this sense, zombie lending and the lost decade can be seen as an example of the potential dark side of the "no fail" bank policy—efficient main bank rescue of the "high growth era" gone bad.\textsuperscript{119}

In 1997, the "no fail" bank policy dramatically ended when the Japanese government allowed the country's tenth-largest bank and fourth-largest securities firm to fail.\textsuperscript{120} Although, these events marked a significant shift in the main bank model, they did not mark its end. After 1997, the government continued to use laws, regulations and informal administrative guidance to shield banks from market forces.\textsuperscript{121} Thus, in a broad sense, little changed post-1997, in that the government continued its general policy of ensuring that it (and not free market forces) ultimately determined when banks should rescue underperforming client companies or let them fail. However, in a more narrow sense, marking a significant change after 1997, the government realized that its unconditional support for banks was unsustainable and that some "creative destruction" was required for the economy to recover from the burst of the bubble.\textsuperscript{122} In short, the line the government set for banks to rescue troubled

\textsuperscript{114} See id. at 49-50.

\textsuperscript{115} See id. at 50-59.


\textsuperscript{117} See id. supra note 116, at 42.

\textsuperscript{118} See id. at 1161-62.

\textsuperscript{119} See id. at 57-59.

\textsuperscript{120} See id. at 59-62.

\textsuperscript{121} See id. at 42.

\textsuperscript{122} See id. at 57-59.

\textsuperscript{117} See id. supra note 116, at 42.

\textsuperscript{118} See id. supra note 117, at 42-59.

\textsuperscript{120} See id. at 58.

\textsuperscript{121} See id. supra note 117, at 42-59.

\textsuperscript{122} See id. supra note 120, at 418-19. For an in-depth analysis of how the government effectively balanced market forces with government intervention to resolve the banking crisis and revive the economy, see Noriyuki Yanagawa, \textit{Rise of Bank-Related Corporate Revival Funds}, CORPORATE GOVERNANCE IN JAPAN 206, 219-22 (Masahiko Aoki et. al. eds., 2007).

\textsuperscript{122} The government continued some of its forbearance policies into the 2000s. For empirical evidence that in the early 2000s the initial unlimited coverage under the deposit insurance plan and the government's continued forbearance policy contributed to shielding banks from market forces, see Masami Imai, \textit{Market Discipline and Deposit Insurance Reform in Japan}, Center on Japanese Economy and Business, Columbia University, Working paper Series (2005), \textit{available at} http://digitalcommons.libraries.columbia.edu/japan_wps/9/. It sent a strong message to the banking
firms shifted toward allowing more (but, not all) underperforming firms to fail.\textsuperscript{123}

The government carried out its post-1997 reform agenda by using a complex combination of forbearance policies and measured market discipline to drive efficient restructuring. On the one hand, it severely restrained creative destruction by providing capital to banks at below-market interest rates, directing regulators to forbear in classifying problem loans, using taxpayer money to help banks dispose of NPLs and allowing banks to utilize accounting gimmicks to meet minimum regulatory capital requirements.\textsuperscript{124} On the other hand, the government forced banks to gradually reduce zombie lending by allowing some banks to fail, creating the Financial Supervisory Agency (FSA) to more diligently enforce banking regulations, by slowly phasing out the deposit insurance scheme and by streamlining corporate bankruptcy legislation.\textsuperscript{125} At the same time, the government ensured that it maintained control over the restructuring process by using a number of government-controlled corporations to help main banks restructure underperforming client companies and by orchestrating mergers between weaker and stronger banks.\textsuperscript{126}

With the benefit of hindsight, the government's post-1997 controlled restructuring policy was remarkably successful in driving banks to reallocate effectively enormous sums of capital from inefficient to efficient sectors of the economy. A recent empirical study, specifically examining the relationship between zombie lending by banks and the reallocation of capital from inefficient to efficient industries (e.g., construction and real estate to manufacturing), confirms that zombie lending significantly declined as the government tightened its banking regulations.\textsuperscript{127}

industry that underperforming banks may be closed by allowing Japan's tenth-largest bank and fourth-largest securities firm to fail in 1997. \textit{See} Milhaupt, \textit{supra} note 103, at 418-19. In addition, the creation of the Financial Supervisory Agency (FSA) in 1999 helped to break the cozy relationship between banks and their former regulator the Ministry of Finance (MOF). \textit{Economist} July 22, 2006, \textit{supra} note 66. There is also evidence that post-2000, the FSA regulators have in fact been more diligent in enforcing banking regulations and forcing banks to write off nonperforming loans to zombie firms. Peek & Rosengren, \textit{supra} note 116, at 1144-45, 1164-65, n. 16; \textit{Dead Firms Walking}, \textit{Economist}, Sept. 25, 2004 [hereinafter \textit{Economist} Sept. 25, 2004].

\textsuperscript{123} This view is generally supported by Steven Vogel. \textit{Vogel}, \textit{supra} note 5, at 25-29, 83-88.

\textsuperscript{124} \textit{See} Puchniak, \textit{supra} note 49, at 45-59.

\textsuperscript{125} \textit{See} Imai, \textit{supra} note 122; Peng Xu, \textit{Corporate Governance in Financial Distress}, \textit{Corporate Governance in Japan} 179 (Masahiko Aoki et al. eds., 2007); \textit{Economist} July 22, 2006, \textit{supra} note 66; \textit{Economist} Sept. 25, 2004, \textit{supra} note 122. In 1998, the Financial Supervisory Agency (FSA) was established as an administrative organ solely responsible for inspection and supervision of private sector financial institutions and surveillance of securities transactions. Prior to 1998, this function was carried out by the Ministry of Finance (MOF). The FSA was created to develop a more focused agency, which was separate from the MOF, to more strictly enforce the law governing banks and other financial institutions.

\textsuperscript{126} Hoshi & Kashyap, \textit{supra} note 66, at 19-22; Saito, \textit{supra} note 89; Noriyuki Yanagawa, \textit{Rise of Bank-Related Corporate Revival Funds}, \textit{Corporate Governance in Japan} 206, 219-22 (Masahiko Aoki et al. eds., 2007). See generally \textit{Vogel}, \textit{supra} note 5, at 83-87.

\textsuperscript{127} \textit{See} \textit{Bank of Japan, Financial System Report, An Assessment of Financial Stability: Focusing on the Banking Sector} 30 (2005), \textit{available at
The conclusion of this study is bolstered by corporate bankruptcy statistics, which also suggest that the government’s post-1997 controlled restructuring policy drove banks to cease lending to zombie firms. One of the major peculiarities in the post-bubble years was the relatively low level of corporate bankruptcies, which resulted from inefficient companies being kept alive by bank loans to zombie firms. After the government ended its “no fail” bank policy in 1997, corporate bankruptcies significantly increased for the first time since the burst of the bubble. In the early 2000s, as the government increasingly tightened the enforcement of banking regulations and forced banks to recognize more of their NPLs, corporate bankruptcies rose dramatically to levels unseen in postwar Japan. In 2000, corporate bankruptcies peaked at close to 19,000 with a record value of approximately US$200 billion—an amount approximately ten-times higher than in 1990 (the year in which the bubble burst) and three-times higher than in 1996 (the year before the government began phasing out its “no fail” bank policy).

The dramatic spike in bankruptcies that corresponded with banks reducing zombie lending illustrates the enormous amount of capital that was shifted from inefficient industries to more efficient ones as a result of the government’s controlled restructuring policy. After spiking in 2000, Japan experienced a steady decrease in the number and value of corporate bankruptcies. In 2006, as a result of the restructuring being completed and healthy banks having disposed of the vast majority of their NPLs, the total value of corporate bankruptcies in Japan reached its lowest level since before the bubble burst—indicating that Japan’s massive government and bank-driven restructuring was over.

Throughout the restructuring, while banks allowed many companies to fail, the government actively ensured that the banking system remained stable by tempering market forces through its extensive forbearance policies. Japan never experienced the economic instability or social panic that often accompanies large financial crises (the costs of which may have been catastrophic). The ability to carry out such a massive reallocation of capital, at an appropriate pace to maintain economic and social stability, was perhaps the government’s greatest accomplishment during the post-1997 controlled restructuring. The


130. See id.

131. See id.

132. See id.

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government’s use of laws, regulations and administrative guidance to restrict free market forces and drive banks to allocate credit efficiently throughout the economy is reminiscent of the high growth era (when the government successfully restricted free markets to provide the appropriate level of incentives for main banks to efficiently rescue underperforming, but potentially productive, companies).134

C. Japan’s Remarkable Recovery: The Fruits of Orchestrated & Friendly M&A

Another significant component of the government’s post-1997 controlled restructuring was the use of legal reforms and administrative guidance to facilitate corporate consolidation and restructuring in Japan’s major industries. Post-1997, friendly M&A between Japanese companies, which was either directly orchestrated or indirectly sanctioned by the government and main banks, resulted in massive consolidation in almost all of Japan’s major industries.135 None of the restructuring was the result of hostile takeovers. In this sense, during the recent recovery, the major restructuring was consistent with the type of government and bank-led restructuring that has been the hallmark of postwar Japanese corporate governance.136 This government and bank-led “friendly restructuring” bares no resemblance to the hostile takeovers-based and market-led restructuring that defined the United States in the 1980s.

Prior to and during the recent recovery, the government and main banks orchestrated a relatively small number of large M&A transactions that changed the face of corporate Japan.137 Over the last decade, these friendly deals have substantially restructured and consolidated almost every major industry: turning fourteen oil companies into four; seven big cement firms into three; fourteen pulp and paper companies into three; seven industrial gas firms into three; five

135. See Lee, supra note 99; Capitalism with Japanese Characteristics, ECONOMIST, Oct. 8, 2005 [hereinafter ECONOMIST Oct. 8, 2005]; MBB Sept. 24, 2006, supra note 12. The level of foreign investment in Japan is shockingly low. According to the Associated Press, “direct foreign investment in Japan amounted to merely 2.1 percent of the country's gross domestic product in 2003, compared with twenty-two percent in the United States and thirty-eight percent in Britain.” Hans Greimel, Japan Warms to Vulture Culture as Merger Boom Grips Nation, AP FIN. WIRE, Apr. 24, 2007. Similarly, in 2007, “foreign investors [got] only a small slice of the market, acting as buyer in just 171 deals last year—a little more than six percent of all mergers involving Japanese companies.” Martin Fackler, Mergers and Acquisitions No Longer Shock Japanese, N.Y. TIMES, Mar. 29, 2007. Conversely, “the number of mergers involving Japanese companies as buyers or sellers more than quadrupled in a decade, to 2,775 deals last year [2006] from 621 in 1996 . . . In most such deals, the buyers were Japanese companies.” Id.
136. According to Kester, as of 1989, Japan had never experienced an M&A wave. However, “several government-sanctioned mergers have played a large role in economic development.” KESTER, supra note 3, at 10.
137. “During the ‘Heisei Malaise’ which began when the ‘bubble economy’ burst in 1990, there have been an increasing number of large public company mergers in Japan, with all ostensibly being ‘friendly’ mergers. In addition, almost all of these mergers have been either promoted, aided or abetted by the Japanese government and major financial institutions, for the express purpose of rationalizing and hopefully revitalizing Japanese industry.” MBB Sept. 24, 2006, supra note 12.
big steel firms into four; and fifteen big banks into three mega-banks. Based on the recent recovery, the large-scale "friendly" restructuring appears to have been extremely successful. Remarkably, Japan's use of "friendly" restructuring has allowed it to preserve its efficient lifetime employment system despite dramatic corporate consolidation and reorganization.

The successful restructuring of Japan's major industries by friendly M&A is often confused with Japan developing a "free market for corporate control" during the recent recovery. Such assertions are normally based on the fact that during the post-1997 restructuring, both the number and volume of M&A transactions substantially increased.

Following the burst of the bubble, the number of M&A transactions hovered around 500 per year. After 1997, the number of M&A transactions significantly increased, tripling to about 1,500 per year in the early 2000s, quadrupling to above 2,000 per year in 2004 and reaching a high of about 2,750 per year in 2005 and 2006. The increase in the value of M&A has been equally as dramatic, rising from US$30 billion in 1994 to a record high of US$162 billion in 2005. At first blush, this dramatic increase in the number and volume of M&A appears to support the assertion that Japan developed a "free market for corporate control" during the recent recovery.

However, an increase in the number and volume of M&A is not tantamount to developing a "free market for corporate control." In fact, a more detailed

138. ABEGLLEN, supra note 5, at 14-18; ECONOMIST Oct. 8, 2005, supra note 135. This paper agrees with James Abeglen's general view that Japan's remarkable recovery is the result of a massive amount of 'friendly restructuring' that has taken place post-1997. However, Abeglen does not give sufficient credit to the role played by the Japanese government and banks—despite the fact that he admits the government has played an important role in reforming Japan's critical banking industry. ABEGLLEN, supra note 5, at 54. For an in-depth analysis of the prominent role that the Japanese government, banks and lifetime employment (i.e., the three main features of the postwar main bank model) played in the recent recovery, see VOGEL, supra note 5. For empirical evidence that Japanese banks played a positive in the post-1997 successful restructuring, see Yasuhiro Arikawa & Hideaki Miyajima, Relationship Banking in Post-Bubble Japan, CORPORATE GOVERNANCE IN JAPAN 51, 73-76 (Masahiko Aoki et al. eds., 2007).

139. During the lost decade and recent recovery, the lifetime employment system was made more flexible as companies hired more part-time workers. However, most Japanese companies still offered lifetime employment to their core employees—even during the massive restructuring. Many scholars view Japan's lifetime employment system as one of its key competitive advantages, which is unsustainable in a vigorous hostile takeovers market. ABEGLLEN, supra note 5, at 73-90; see also VOGEL, supra note 5, at 79-83, 119-20, 146.

140. See COLCERA, supra note 17, at 49-52; Schaede, supra note 16, at 20-21.

141. See 2005 CORPORATE VALUE REPORT, supra note 8, at 26.

142. COLCERA, supra note 17, at 50. For current statistics on the number of M&A's in Japan since the burst of the bubble, see RECOF CORPORATION'S M&A CHART, available at http://www.recof.co.jp/english/column/ma_trend.html. Despite the fact that the number of M&As in Japan have increased dramatically, they pale in comparison to the number of M&A's in the US and Europe. According to a 2007 report, "The 2,775 M&A deals in Japan in 2006 were but a fraction of 13,691 in America and 14,702 in Europe, according to Thomson Financial." Greimel, supra note 135.

examination of M&A statistics during Japan's recent recovery suggests the opposite—M&A in Japan remained largely restricted and controlled during the recent recovery. From 2000 to 2005, more than seventy percent of all M&A deals in Japan involved small, unlisted companies.\textsuperscript{144} By definition, all of these transactions were friendly consensual deals as they occurred between small, closely held companies—which is the opposite of an American-style market for corporate control. Also, due to their small size, these transactions had only a limited impact on restructuring the economy.

In addition, despite grabbing most of the newspaper headlines, foreign companies were virtually locked out of Japan's M&A market during the recent recovery. The percentage of M&A deals involving foreign companies remained below ten percent throughout the lost decade and declined to about five percent after 2004.\textsuperscript{145} Of the few M&A deals involving foreign companies, the majority were with small, unlisted Japanese companies that either already had an existing relationship or were the subsidiary of the foreign company.\textsuperscript{146} The handful of large M&A deals involving foreign companies, such as Nissan or Long Term Credit Bank, was with extremely distressed Japanese companies that were anxious to be rescued.\textsuperscript{147} The government also kept a "short leash" on foreign companies following these rare large foreign transactions to ensure that they understood their "proper role" in restructuring corporate Japan.\textsuperscript{148}

In turn, this picture of M&A in Japan during the recent recovery is strikingly similar to M&A in Japan throughout the entire postwar period. Since World War II, Japan has consistently had a significant number of small friendly M&A transactions, without an American-style "free market for corporate control."\textsuperscript{149} This is because in postwar Japan, the government and main banks have controlled the most significant M&A transactions, and hostile takeovers have been absent.\textsuperscript{150} Detailed statistics illustrate that this trend held true during

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\item \textsuperscript{144} EIU 2005, supra note 15, at 4.
\item \textsuperscript{145} Id. at 4, 16.
\item \textsuperscript{146} Id. at 4.
\item \textsuperscript{147} Id. In addition, most evidence suggests that foreign companies have failed to succeed in restructuring Japanese companies that have failed under Japanese management. ABEGGLEN, supra note 5, at 20.
\item \textsuperscript{148} See Puchniak, supra note 49, at 56. The takeover of Long Term Credit Bank (formerly, one of the top 10 banks in Japan) by Ripplewood (an American private equity firm) is an example of the Japanese government keeping a "short leash" on a foreign acquirer. In 2001, following the Ripplewood takeover, the government applied an enormous amount of pressure to the new American management of LTCB (which had been re-launched after its restructuring under the new name, Shinsei Bank) to continue lending to firms that were essentially bankrupt—because this was how banks were "supposed to act" in corporate Japan. See id.; see also TETT, supra note 72, at 227-37; Jason Singer & Phred Dvorak, Shinsei Bank Pressured to Keep Shaky Loans, WALL ST. J., Sept. 26, 2001, at C1.
\item \textsuperscript{149} According to Kester, "A market for corporate control has not developed in Japan because Japan has not needed it, not because it did not want it or could not tolerate it. Corporate governance will remain the decisive determinant of whether a market for corporate control develops." KESTER, supra note 3, at 271.
\item \textsuperscript{150} See supra note 41; see also Schaebe, supra note 16, at 6.
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the recent recovery as the vast majority of M&A transactions were between small, unlisted Japanese companies and of little significance. The much smaller number of significant M&A transactions were friendly and orchestrated deals driven by the government and main banks. Foreign companies had a negligible influence in the M&A market. None of the deals were the product of hostile takeovers. In sum, restructuring during the recent recovery was consistent with Japan’s traditional main bank corporate governance system—which is propelled by the “efficiency of friendliness.”

D. Japan’s Remarkable Recovery: Legal Reforms Supported Japanese and Friendly M&A

Although M&A during the recovery was generally consistent with past practices, the government did significantly reform the laws governing M&A, which sheds light on both the increase in friendly M&A between Japanese companies, as well as the continued limited involvement of foreigners and hostile takeovers in the restructuring process. In 1997, the government began reforming Japan’s legal framework by amending the Anti-Monopoly Act to allow for the creation of holding companies to promote reorganization. In the same year, the government streamlined the legal framework for conducting M&A, making deals less costly and quicker to accomplish. In 1999, the government revised the Commercial Code to allow domestic companies to conduct share-for-share exchanges (with tax deferral on such deals granted in 2000), which also significantly enhanced the attractiveness and viability of M&A for Japanese companies. Again, in 2001, the government amended the Commercial Code to facilitate friendly M&A by providing a new system for corporate spin-offs.

While the government tried to facilitate friendly M&A between Japanese companies, it took the opposite approach towards foreign M&A and hostile takeovers. It explicitly excluded foreign companies from the 1999 share-for-share exchange amendment, which significantly impaired their ability to

151. See KESTER, supra note 3, at 94, 96, 104-05.
153. Japan’s legal framework for conducting M&As was streamlined by abolishing one of the two shareholder meetings required to approve a merger. In addition, the requirements for notifying individual creditors of a merger were abolished. Finally, short-form mergers were permitted, whereby the approval of the acquiring company’s shareholders was no longer required if the size of the acquired company was less than five percent of the acquiring company. Zenichi Shishido, Changes in Japanese Corporate Law and Governance: Revisiting the Convergence Debate, University of California Berkeley, Law and Economics Workshop, Paper I (2004), available at http://repositories.cdlib.org/berkeley-law_econ/ Fall2004/1/.
155. See id. For an overview of the reforms to Japan’s corporate law and M&A regime that took place during the lost decade, see Milhaupt 2003, supra note 82, at 14-17.
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carryout M&A in Japan. Without the ability to conduct share-for-share exchanges, foreign companies could not use their shares as acquisition capital or perform tax-free acquisitions of Japanese companies. After years of lobbying by the United States government, it appeared that the New Company Law (that took effect in May 2006) would finally allow foreign companies to conduct share-for-share exchanges. However, the provision in the New Company Law that lifted the restriction on foreign share-for-share exchanges was delayed for a year because the government feared that it would cause a wave of foreign hostile takeovers.

Then, in May 2007, the government finally lifted the restriction on foreign share-for-share exchanges only to then implement a new (albeit less prohibitive) restriction. It decided that foreign share-for-share exchanges would only receive tax deferred treatment if the deal was done through a Japanese subsidiary that had “relations with” the company being acquired. This rendered the long awaited provision for foreign share-for-share exchanges virtually useless for all foreign companies except those that already had a well-established subsidiary in Japan.

The government’s approach to hostile takeovers has been equally as restrictive as its approach to foreign M&A. In 2001, the government amended the Commercial Code to allow companies to implement the poison pill—a powerful hostile takeover defense. Again, in May 2005, due to some uncertainty about the 2001 poison pill amendments, the Ministry of Economy, Trade and Industry (METI) and the Ministry of Justice “officially sanctioned” the poison pill for use in the Japanese market. In May 2006, the New Company Law further extended the availability of the poison pill by increasing the types of poison pills available under Japanese law. In the same year, the FSA and METI went one step further by pressuring the TSE to amend the draft of its new listing rules to allow listed companies to issue golden shares—another powerful takeover defense which is prohibited by the New York Stock Exchange. In the past year, the government has explicitly encouraged companies—in certain industries that it has deemed vulnerable to foreign

156. See Milhaupt & West, supra note 3, at 31-33.
157. See id.
158. David Ibison, Defences Against Foreign Aggressors Add to Investor Fears, FIN. TIMES, June 27, 2005.
160. Id.
162. Milhaupt, supra note 2, at 2200.
163. According to Hines, “in addition to the types of poison pills currently available under Japanese law, the Corporation Law permits Japanese companies to issue a poison pill that can limit the voting rights of a hostile acquirer, in contrast to the customary dilution of voting power in a flip-in/flip-out pill in the United States.” Hines et al., supra note 22, at 363-64.
164. Id. at 368.
hostile takeovers—to adopt the poison pill. It is important to remember that all of these reforms “to stop hostile takeovers” have taken place in the only developed country that has not had a successful hostile takeover bid in the postwar era. 

It appears that the government has succeeded in fostering restructuring through M&A, while at the same time maintaining control over the M&A process by limiting foreign and hostile M&A. As discussed in the aforementioned M&A statistics, foreign and hostile M&A had a marginal impact during the recent recovery. At the same time, Japan’s major industries were efficiently consolidated through government and bank-led M&A, and friendly M&A transactions between Japanese companies considerably increased.

E. A “Hostile Takeovers Utopia”—But Still No Hostile Takeovers

The conspicuous absence of hostile takeovers in Japan’s recent recovery is even more remarkable considering that, at least in the opinion of most experts, market conditions for hostile takeovers during the recent recovery were close to optimal. Prior to and during the recent recovery, the bust-up values of a substantial percentage of Japan’s listed companies were considerably more than their cumulative stock price and almost all of Japan’s “barriers” to hostile takeovers (e.g., stable-shareholdings, a cultural aversion to hostility, and inefficient laws) were eroded. To many M&A experts familiar with Tokyo’s business environment, Japan appeared to be a utopia for hostile takeovers. Yet, despite the pro-hostile takeover business climate, there has never been a successful hostile takeover bid during Japan’s recovery period.

The mirage of a “hostile takeovers utopia” in Japan was the result of two decades of countless predictions by M&A experts that a vigorous hostile takeovers market was perpetually on the horizon. These predictions were

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165. See ECONOMIST Sept. 9, 2006, supra note 22.

166. IHT Sept. 6 2006, supra note 12.

167. See Jacobs, supra note 14, at 327; Milhaupt, supra note 2, at 2175, 2189; Ibison, supra note 14; Turner, supra note 14.

168. For information regarding the unwinding of stable-shareholdings, see Milhaupt 2003, supra note 82, at 13-14; Schaede, supra note 16, at 12-15. For information regarding the erosion of legal barriers, see Gilson, supra note 1, at 22; Milhaupt 2003, supra note 82, at 4-11; Milhaupt & West, supra note 3, at 21-22. For information regarding the erosion of cultural barriers, see COLCERA, supra note 17, at 74; Douglas G. Gruner, Note, Chilled To The Pill: The Japanese Judiciary's Cool Reception Of The Poison Pill And Potential Repercussions, 67 U. PITT. L. REV. 871, 895 (2006).

169. Turner, supra note 14. See generally Milhaupt, supra note 2, at 2189. Even during the lost decade, foreigners have been very bullish on the inevitable rise of hostile takeovers in Japan. ECONOMIST July 19, 1997, supra note 19.

170. According to a 2004 article by Gilson, “each report of a reduction in the size of crossholdings among Japanese companies and in the size of Japanese bank stockholdings in their clients has given rise to an expectation that now, at last, hostile offers would emerge.” See Gilson, supra note 1, at 21. Surprisingly, in the same article Gilson erroneously predicts, “A number of events now suggest that the long wait for hostile transactions in Japan may be approaching its end.” Id. at 29. Such predictions
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largely based on the false assumption that Japan would inevitably follow the United States and teleologically evolve towards the “optimally efficient” hostile takeovers-based American corporate governance model. Therefore, predicting the future of Japanese corporate governance merely involved plotting where Japan fell on the evolutionary path that the United States had already taken.

In this vein, after the burst of the bubble, many M&A experts viewed Japan as strikingly similar to the United States during the 1980s. Keiretsu were viewed as tantamount to the inefficient conglomerates, which were efficiently dismantled by hostile takeovers in the United States during the 1980s. Similar to America in the 1980s, shareholders stood to gain from hostile takeovers that would force entrenched managers either to focus on shareholder value or be culled from the market. Most importantly, the bust-up values of a substantial portion of Japan’s large listed companies were below their cumulative stock price—a phenomenon that, in the late 1980s, drove a wave of hostile takeovers in the United States. It was assumed that the potential to make enormous profits in Japan’s undervalued market would axiomatically lead to a wave of American-style hostile takeovers. In the words of one M&A commentator, “[i]f there are profits to be had, hostile takeovers will increase...this cannot be stopped, even if it doesn’t suit Japan’s culture.”

preceded the burst of the bubble. In 1989, the CEO of a famous United States’ merchant bank predicted that with the globalization of capital markets, “value-maximizing investors would use takeovers to replace underperforming managers, change corporate policies, and dramatically restructure companies with the aim of increasing equity value.” KESTER, supra note 3, at 3. They theorized that Japan would be part of this market and therefore be part of a market for corporate control that looked like America in the 1980s. Id. In his 1991 book, Kester predicted, based on a few failed hostile takeover attempts at the time, that “ultimately, both attempts failed to win control of companies targeted. But the surprising inroads made in each case demonstrates the extent to which the Japanese market for corporate control has changed and foreshadow the more frequent use of Anglo-American tactics in future battles for corporate control of Japanese companies. While it is premature to forecast a convergence of the Japanese market with the West’s, these examples make it evident that a newly active market for corporate control in Japan will fill the void left by receding capital market discipline.” Id. at 239. In 2001, the Economist reported that, “analysts predicted that a new wave of similar [unfriendly] bids might follow. Some even forecast the imminent arrival of an ‘Anglo-American’ M&A (mergers and acquisitions) market, where investment banks, company bosses and investors would wrestle for control of companies.” ECONOMIST Feb. 17, 2001, supra note 15. In his 2005 article, Milhaupt predicted that “the world’s second-largest economy is in the process of embracing hostile M&A (however reluctantly).” Milhaupt, supra note 2, at 2174.

171. Puchniak, supra note 13, at 20.

172. According to Hines, “a widely shared opinion is that Japan is currently experiencing an increase in takeover activity that is comparable to the heyday of U.S. takeovers during the mid-to-late 1980s, a time which largely provided the foundation for present American takeovers jurisprudence.” Hines et al., supra note 22, at 360; see also Milhaupt, supra note 2, at 2176.


174. Gilson, supra note 1, at 22.

175. Michiyo Nakamoto, A Takeover Battle Launched by the Upstart Livedoor is a Test of How Much Big Corporate Groups Can Protect Themselves Against Unwanted Attention, FIN. TIMES, Mar. 22, 2005.
Prior to and during the recent recovery, there is no question that the possibility of conducting hostile takeovers in Japan’s undervalued stock market presented a tantalizing opportunity to turn quick and sizable profits with a minimal amount of risk. It was well recognized that a significant percentage of large listed Japanese companies had a cumulative stock price that was considerably less than their bust-up value. In 2001, Milhaupt and West reported that thirteen percent of the TSE’s non-financial companies traded at below their liquidation value. In the same year, The Economist reported that “there [were] pots of gold hidden everywhere” in Japan as about ten percent of its 3,500 listed companies had break-up values of more than twice their cumulative stock price. In 2005, The Economist Intelligence Unit reported that about twenty-five percent of Japanese companies had bust-up values less than their cumulative stock price and that these companies were ripe for hostile takeovers as “a faster way to make money [was] hard to find.”

The absence of hostile takeovers, which defied American corporate governance precedent and failed to capitalize on a plethora of opportunities to turn an easy profit, created a conundrum. As explained above, prior to the burst of the bubble it was generally accepted that the main bank model served as an efficient substitute for hostile takeovers, which made them unnecessary. However, after the bubble burst, most experts viewed the main bank model as either fundamentally flawed or no longer relevant. As a result, during the lost decade and throughout the recent recovery, most experts concluded that the idiosyncratic “barriers” in the Japanese market caused this dearth of hostile takeovers. There was a general consensus that if Japan wanted its economy to recover, it had to eliminate these “barriers” and allow hostile takeovers to effectively restructure underperforming companies—as had happened in the United States during the late 1980s.

The most often cited “barriers” to hostile takeovers in Japan were cross-shareholdings, Japanese culture, and inefficient laws governing hostile takeovers. After the bubble burst, each time one of these “barriers” eroded,  

176. Milhaupt & West, supra note 3, at 28.
179. See Milhaupt & West, supra note 3, at 6, 47.
180. Professor Gilson notes that, “[b]efore the bursting of the Japanese ‘bubble economy,’ the main bank system represented the future . . . Not long thereafter, the Japanese bubble burst and the American economy boomed . . . The American system then became the apparent end point of corporate governance evolution.” Gilson, supra note 5, at 331. Professors Miwa & Ramseyer also note that by the end of the lost decade “within Japan many scholars . . . [were] suggest[ing] using the law to dismantle the ‘main bank system.’ Adopt instead, they argue[d], the classic governance arrangements involving director and shareholder oversight.” Miwa & Ramseyer, supra note 5, at 409; see also Milhaupt, supra note 5, at 428.
181. See supra note 170.
182. See VOGEL, supra note 5, at 1, 144-45; Gilson, supra note 1, at 22.
183. See supra note 170.
fresh predictions would inevitably emerge that the arrival of hostile takeovers was imminent.\textsuperscript{184} As explained in detail below, by the time the lost decade ended, all of the so-called “barriers” had substantially eroded. However, the much-anticipated wave of successful hostile takeovers did not hit Japan. Despite the years of predictions, Japan remained (and still remains) the only developed country without a successful hostile takeover bid during the postwar period.\textsuperscript{185}

Stable shareholdings between friendly corporations and financial institutions have traditionally been seen as the most significant barrier to hostile takeovers in Japan. At their postwar peak, stable shareholdings reached a high of about seventy percent, which made it mathematically impossible to conduct hostile takeovers.\textsuperscript{186} However, during the lost decade, stable shareholdings substantially declined from about forty-three percent in 1990 to twenty-six percent in 2002.\textsuperscript{187} This was accompanied by a rise in foreign shareholdings from about four percent in 1989 to about nineteen percent in 1999.\textsuperscript{188} Throughout the lost decade and recent recovery, many experts predicted that the combination of the decrease in stable shareholdings and rise in foreign shareholders would open the floodgates for hostile takeovers in Japan.\textsuperscript{189} These experts assumed that Japanese managers would no longer be able to rely on stable shareholders to block hostile takeovers, making inefficient companies with undervalued stocks easy targets.

Japanese culture has also long been considered to be a significant barrier to hostile takeovers.\textsuperscript{190} Almost every analysis of hostile takeovers in Japan mentions the “cultural distaste” that the Japanese have for the sale of a company and the “taboo” associated with hostile takeovers.\textsuperscript{191} Japanese managers were seen to have a sense of “corporate paternalism” toward employees, which made it shameful to allow their “family” to be the victim of a hostile takeover.\textsuperscript{192} The concept that Japanese corporations were more like families than profit machines provided a rationale for stable shareholders to protect each other from hostile takeovers despite short-term economic losses resulting from forgoing lucrative tender offers. In this sense, Japan’s unique

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\item \textsuperscript{184} Gilson, supra note 1, at 22.
\item \textsuperscript{185} IHT Sept. 6, 2006, supra note 12.
\item \textsuperscript{186} EDWARD J. LINCOLN, ARTHRITIC JAPAN 30 (2001).
\item \textsuperscript{187} Fumio Kuroki, The Relationship of Companies and Banks as Cross-Shareholdings Unwind - Fiscal 2002 Cross-Shareholding Survey, NLI Research, Fig.3 (2003), available at http://www.nli-research.co.jp/eng/resea/econo/eco031118.pdf.
\item \textsuperscript{189} See, e.g., Milhaupt, supra note 2, at 2189.
\item \textsuperscript{190} See COLCERA, supra note 17, at 53-74; Milhaupt, supra note 3, at 2090-91.
\item \textsuperscript{191} COLCERA, supra note 17, at 53; Milhaupt, supra note 3, at 2090-91; Milhaupt & West, supra note 3, at 22.
\item \textsuperscript{192} Milhaupt, supra note 3, at 2090-91; Milhaupt & West, supra note 3, at 22.
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Corporate culture helped explain why the "profit motive" failed to drive hostile takeovers in Japan's undervalued market.

During the lost decade and recent recovery, there were numerous reports that Japan's unique corporate culture, which placed relationships over short-term profits, had significantly eroded. The widely publicized takeover attempts by Horie and Murakami were cited as evidence that Japanese corporate culture was tolerant, if not accepting, of hostile takeovers. During the recent recovery, many experts suggested that maximizing shareholder profits became the most important incentive for Japanese managers as it was "no longer considered acceptable" for management of stable shareholder companies to block hostile takeover bids "regardless of the financial consequences to their own shareholders". A general consensus emerged that Japan's corporate culture was no longer a major barrier to hostile takeovers.

The laws governing hostile takeovers in Japan have also traditionally been seen as a significant "barrier" to hostile takeovers. Experts have complained that low levels of disclosure and idiosyncratic rules governing tender offers made hostile takeovers unattractive in Japan. However, many experts suggest that legal reforms made prior to and during the recent recovery significantly eroded these "legal barriers" to hostile takeovers.

Historically, financial disclosure requirements for Japanese companies were less stringent than in other developed countries. Some experts suggested that this significantly increased the costs and risks of conducting hostile takeovers in Japan. However, in the late 1990s, amendments to the Commercial Code and Securities Regulation significantly expanded the scope of required disclosure, bringing Japanese accounting rules into conformity with International Accounting Standards. This substantially reduced any "disclosure barrier" for conducting hostile takeovers.

Japan's idiosyncratic legal regime governing tender offers has also been cited as a potential legal barrier to hostile takeovers. Prior to 1971, the legality of tender offers in Japan was uncertain because there were no rules governing them, which some experts suggest may have been part of the reason why no tender offers were made during this period. In 1971, Japan implemented an

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193. COLCERA, supra note 17, at 74.
194. See Milhaupt, supra note 2, at 2192; Kingston, supra note 17; TIME Feb. 7, 2000, supra note 173.
195. Milhaupt, supra note 2, at 2186.
196. COLCERA, supra note 17, at 74.
197. See Gilson, supra note 1, at 22; Milhaupt 2003, supra note 82, at 4-11.
198. Milhaupt & West, supra note 3, at 18.
199. The amendments to the Commercial Code and Securities Regulation required companies to use market-to-market accounting, consolidated financial statements and increased the scope of information required to be stated on financial statements. Id. at 33.
200. Milhaupt & West, supra note 3, at 19. See generally Keisho Komoto, The Present Status of Takeover Bids (TOB) and Their Effect on Stock Prices (NLI Research No.147, 2000), available at
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idiosyncratic and restrictive tender offers regime under the Securities and Exchange Act. These idiosyncratic rules are also viewed by some as a reason that only a few friendly tender offers were made during the two decades that they were in force. However, in 1991, Japan amended the Securities and Exchange Act, loosely patterning it after London’s City Code and in 2005 the government issued the Takeover Guidelines, which substantially incorporated Delaware takeover jurisprudence regarding defensive measures into Japanese law. This more “standard” hostile takeovers bid regime substantially eliminated any argument that Japan’s idiosyncratic legal framework was a barrier to developing a hostile takeovers market similar to other developed countries, such as the United Kingdom and the United States.

In sum, during the recent recovery, there was an abundance of undervalued Japanese companies that appeared ripe for hostile takeovers. All of Japan’s so-called “barriers” to hostile takeovers substantially eroded. However, there was not a single successful hostile takeover of a major Japanese company. This suggests that the lack of hostile takeovers cannot be explained by these perceived “barriers.” As explained in section six below, a better explanation for the absence of hostile takeovers during Japan’s recent recovery is that they were simply unnecessary. This is the same reason that hostile takeovers failed to emerge prior to the burst of the bubble. Once again, Japan’s unique system of corporate governance appears to have achieved a high level of efficiency.


203. The amendment to the 1991 Securities and Exchange Act required that an off-exchange offer, the acceptance of which would result in the acquisition of more than 33.3 percent of the target’s shares, be made through a tender offer open to all shareholders. According to Milhaupt and West, this provision is loosely patterned after London’s City Code. See Milhaupt & West, supra note 3, at 19-20. See generally KESTER, supra note 3, at 99-102. However, in contrast to the mandatory bid rule of the City Code, the offer does not have to be for all outstanding shares. Milhaupt, supra note 2, at n.120. In 2006, at the time that Japan’s recent recovery was ending, Japan’s tender offer rules were substantially amended. See Osugi, supra note 12, at 154-55.


205. Although, as argued in the previous section, the implementation of the poison pill and other takeover defenses should be viewed as a move by the government to constrain hostile takeovers, some prominent American scholars suggest the opposite. Professors Milhaupt and West argue that the inability to implement American-style defensive measures forced Japanese managers to resort to “the draconian, relationship based defense of cross-shareholding, which is generally unreviewable by the courts”. In this light, they argue that allowing flexible takeover defenses, like the poison pill, actually works to encourage efficient hostile takeovers. Therefore, at least from the perspective of the American model, even the revision to the Takeover Guidelines and earlier amendments to the Commercial Code, which made the poison pill available in Japan, can be viewed as reducing the “barriers” to hostile takeovers. Milhaupt & West, supra note 3, at 21. For an overview of the development of the law governing Japanese takeover bids, which takes a slightly different perspective, see Osugi, supra note 12, at 149-56.
without hostile takeovers. In this respect, little has changed in the "new era of globalization" as the "efficiency of friendliness" has continued to drive Japanese corporate governance.

IV. THE MARGINAL EFFECT OF FAILED HOSTILE TAKEOVERS ON THE RECENT RECOVERY

A. Failed Hostile Takeover Attempts Have Not Significantly Increased the Threat of Hostile Takeovers

The absence of successful hostile takeovers during the recent recovery is a historical fact. This fact presents a problem for the cadre of corporate governance experts who are intent on drawing strained comparisons between Japan's non-existent hostile takeovers market during the recent recovery and the vigorous hostile takeovers market that drove restructuring in the United States during the 1980s. As a result, some experts have tried to rely on failed hostile takeover attempts as evidence that hostile takeovers have played a significant role in Japan's recent recovery. This argument is seriously flawed.

From a corporate governance perspective, hostile takeovers are important because, given that share price reflects expected company performance, outsiders who believe that they can improve a company's performance have an incentive to acquire its shares. In theory, competition among outsiders ensures that the company's resources will be acquired by the outsider who can run the company most efficiently. Efficiency is increased \textit{ex post} as the acquirer replaces management who is either less competent or not acting in the best interest of shareholders. In this way, hostile takeovers ensure that managers and companies that do not maximize shareholder value do not survive. In addition, hostile takeovers raise efficiency \textit{ex ante} because the threat of hostile takeovers forces incumbent management to maximize shareholder value and reduce agency costs.

\begin{itemize}
  \item 206. See \textit{supra} note 12.
  \item 207. See \textit{supra} note 30.
  \item 208. According to Schaede, "whether or not a hostile bid is launched or eventually successful is not as relevant as the potential threat of a hostile takeover." Schaede, \textit{supra} note 16, at 25. Similarly Milhaupt posits, "though the number of unsolicited bids is still very low by any measure and no bid thus far has been an unqualified success . . . it is not the number, but the existence, of hostile bids that matters from a corporate governance perspective." Milhaupt, \textit{supra} note 2, at 2183; see also Gilson, \textit{supra} note 1, at 29; Gruener, \textit{supra} note 168, at 895; Christian Caryl, \textit{End of a Rebel Culture?}, NEWSWEEK INT'L., Jan. 30, 2006; Nakamoto, \textit{supra} note 175.
  \item 209. Burkart & Panunzi, \textit{supra} note 2, at 3.
  \item 210. \textit{Id}.
  \item 211. \textit{Id}.
  \item 212. \textit{Id}.
\end{itemize}
The Efficiency of Friendliness

The *ex post* efficiency gains achieved by replacing underperforming management obviously do not arise in the case of failed hostile takeovers because incumbent management maintains their position *ex post*. In turn, the claim that failed hostile takeovers impact corporate governance is largely based on the assumption that they raise efficiency *ex ante* by increasing the perceived threat of successful hostile takeovers. Therefore, those who claim that failed hostile takeovers in Japan have significantly affected corporate governance are more accurately claiming that failed hostile takeovers have significantly increased the threat of successful hostile takeovers. As explained below, case study and empirical evidence does not support this conclusion.

B. Failed Hostile Takeovers Were Not a Novel Feature of the Recent Recovery

In order to argue that failed hostile takeovers increased efficiency *ex ante* during the recent recovery, hopeful M&A pundits have erroneously claimed that hostile takeover attempts were a novel feature of the recent recovery. Labeling hostile takeover attempts as novel allowed experts to suggest that, even though all of the takeover attempts during the recent recovery failed, the novelty of the attempts increased the perceived threat of hostile takeovers and thus increased the *ex ante* efficiency of hostile takeovers in Japan.

A recent article by Milhaupt, which is based on a number of failed (but no successful) hostile takeover attempts between 2000 and 2005, illustrates how experts have exaggerated the novelty and significance of failed hostile takeovers during the recent recovery. Milhaupt admits that there were not any successful hostile takeovers during the recent recovery. However, he then erroneously declares that, "the unthinkable has happened", "hostile takeovers have arrived in Japan". Such a claim suggests that the mere presence of hostile takeover attempts during the recent recovery represented a dramatic shift in Japanese corporate governance. This is an error.

That hostile takeovers were attempted during the recent recovery is far from "unthinkable". To the contrary, for decades the control rights of asset-rich Japanese companies with languishing stock prices have been sporadically targeted by maverick Japanese and foreign investors. Target companies in Japan have consistently used defensive measures, which have normally involved relying on assistance from friendly stable shareholders, to prevent

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213. Id. at 2.
214. Id. at 3.
215. See Milhaupt, supra note 2, at 2177-81.
216. See id. at 2181, 2184.
217. Id. at 2171-72.
acquirers from successfully gaining control.\textsuperscript{219} On numerous occasions over the past several decades, acquirers have responded to these defensive measures by commencing legal proceedings in which they attempted to have the court set aside defensive measures on the basis that their “primary purpose” was to entrench target management and not to increase shareholder value.\textsuperscript{220} In some instances, acquirers have succeeded in having Japanese courts strike down defensive measures.\textsuperscript{221} In other instances (more often in the 1980s than during the recent recovery), aggressive shareholders have pressured target management to repurchase shares at a significant premium to avoid being acquired and to maintain their ultimate control.\textsuperscript{222} These facts about Japan’s hostile takeover environment over the last several decades are unremarkable when compared to the United States and to many other developed countries.

However, what distinguishes Japan from the United States, and most other developed countries, is that attempted hostile takeovers have been almost universally unsuccessful in removing control from target management.\textsuperscript{223} This did not change during the recent recovery. In addition, the trend that hostile takeovers have been attempted mainly by those outside of Japan’s established business community remained largely intact. Both the consistent failure of hostile takeovers to remove \textit{de facto} control rights from Japanese management and their status as being driven mainly by marginal players in the business community have relegated hostile takeovers to a footnote in postwar Japanese corporate governance—even during the recent recovery.

An examination of the failed hostile takeover attempts in Japan prior to the burst of the bubble demonstrates that failed hostile takeovers existed long before the recent recovery. Two of the most notorious large-scale hostile takeover attempts in the 1980s were Video Seller’s attempt to take over Fujiya\textsuperscript{224} and Trafalgar-Glen’s attempt to take over Minebea Company.\textsuperscript{225}

\begin{itemize}
  \item \textsuperscript{219} See, e.g., KESTER, \textit{supra} note 3, at 256; Tokumoto, \textit{supra} note 218, at 5-11; Mitsuhiro Kamiya, \textit{The Possible Implications of Japanese Court Decisions on Defensive Measures for Japanese Corporate Governance}, presented at Kyushu University’s Corporate Governance in East Asia Conference 5 (Feb. 10, 2007) (unpublished paper, on file with author).
  \item \textsuperscript{220} Saywell Martin, \textit{The Ultimate Barrier Revisited: Mergers and Acquisitions in Japan}, reprinted in ODA HIROSHI, \textit{JAPANESE COMMERCIAL LAW. IN AN ERA OF INTERNATIONALIZATION} 55 (1994); Tokumoto, \textit{supra} note 218, at 5-11.
  \item \textsuperscript{221} See, e.g., Shuwa v. Inageya, 1317 HANREI JIHO at 28 (Toyko D. Ct., July 2, 1989).
  \item \textsuperscript{222} KESTER, \textit{supra} note 3, at 237-62.
  \item \textsuperscript{223} The approximate success rate of hostile deals in the US is thirty-five percent, and in EU is fifty percent. Hines et al. \textit{supra} note 22, at 436-437. Until 1999, Germany was the other major developed economy that had not yet had a successful hostile takeover bid. However, that changed in spectacular fashion when Vodaphone was successful in its hostile takeover of Mannesmann. See William Boston, \textit{Hostile Deal Could Breach German Resistance}, WALL ST. J., Nov. 17, 1999. In Europe, from 1990-1999, there were 222 hostile bids (68 in the continent), a number of which were successful. Kirchner & Painter, \textit{supra} note 44, at 27.
  \item \textsuperscript{224} In the 1980s, Fujiya was one of Japan’s ‘Big Five’ confectionary companies and was listed on the First Section of the Tokyo Stock Exchange. With a 70-year history and over 100 billion yen in yearly sales, Fujiya was a major Japanese company that was part of Japan’s business establishment. Until the early 1980s, Fujiya was firmly managed and controlled by the Fuji family which controlled
  \item \textsuperscript{225}
\end{itemize}
The Efficiency of Friendliness

While the Video Seller's takeover attempt was driven by aggressive Japanese private investors and Trafalgar-Glen's attempt by aggressive foreign investors,

about twenty percent of the Fujiya's stock—*with major financial institutions owing about thirty percent, other corporations six percent and the balance of the shares held by individuals. Although profits of the confectionary business had been declining for almost a decade and Fujiya's stock languished as a result, Fujiya had substantial real estate and equity holdings which made the company a prime takeover target. In 1982, Ginzo Korekawa, an aggressive and experienced private investor, seized upon this opportunity and began accumulating Fujiya's shares on the open market. By March 1983, Korekawa had purchased twelve percent of Fujiya's shares and the stock price had risen from 295 yen per share to 580 yen per share. At this point, Korekawa offered to sell his shares to a shareholder of Fujiya's choosing for 500 yen per share. Fujiya's management hesitated and as a result Korekawa sold his shares in an off market transaction to Video Seller at a price estimated between 500 to 600 yen per share. Video Seller was a company that specialized in targeting companies in which it could acquire large shareholding positions and prompt a related company to repurchase those shares at a profit. In 1985, Video Seller controlled 39.6 percent of Fujiya's shares, which had risen to 1,620 yen per share. Video Seller approached Fujiya's management with an offer to sell its shares. Fujiya's management declined believing that its stable shareholders still controlled enough shares to ensure that they maintained control. However, Fujiya approached its banks and other stable shareholders to purchase more stock to ensure that it maintained control. By late November 1986, Video Seller had managed to acquire 47.5 percent of Fujiya's shares. Rumors developed that Video Seller had engaged an agent to sell its stake to an American company. It was also reported that some of Fujiya's "stable shareholders" had sold their shares to other shareholders that would support Video Seller. At this point, Video Seller announced its intention to acquire a controlling majority stake, but made a final offer to Fujiya's management to sell its stake. The long hostile dispute ended on December 7, 1986 when Fuji Merchant, an affiliate of Fujiya agreed to buy Video Seller's shares for 1,250 yen per share. Funds for the purchase were arranged through banks and insurance companies associated with Fujiya and Fujiya was central in arranging the purchase. The main reason expressed by Fujiya for finally arranging the purchase of the shares was because an American food processing company had expressed interest in buying Video Seller's position. For a more complete summary of the facts, see KESTER, *supra* note 3, at 239-44.

225. In 1984, Minebea was a diversified Japanese company with 131 billion yen in annual sales. Despite its large sales, Minebea's return on equity was very low and it had 61 billion yen in cash which made it a prime target for a hostile takeover. In August 1985, at the same time that Minebea was attempting a hostile takeover of Sankyo Seiki Manufacturing Co., Glen International Financial Services Co., which was controlled by a former British stockbroker, moved to swiftly acquire 4.6 percent of Minebea's shares on the open market. Without Minebea's knowledge, Glen International quietly accumulated large blocks of equity warrants and convertible bonds that quickly raised its control of Minebea's common stock to thirty percent. At this point, Glen International reportedly offered Minebea a chance to repurchase its shares for 1,150 yen—nearly double the price that they were listed on the Tokyo Stock Exchange. Minebea rejected the offer. Then, Glen International sold an option to sell its stake in Minebea to Trafalgar Holdings Ltd., a small US savings and loan bank, which drove Minebea's stock price from 600 to 845 yen in under two weeks. Minebea responded swiftly with defensive measures by issuing 16 billion yen of subordinate debentures convertible into 20 million shares of common stock (5.6 percent of Minebea's shares) to stable shareholders. The defensive measures caused Minebea's stock price to fall by about ten percent and prompted Trafalgar-Glen to make a formal offer to purchase all of Minebea's outstanding shares. Minebea's management considered the offer an insult and vowed to use all means necessary to prevent the hostile takeover. Within days, Minebea merged with Kanemori Co. (in which it already held a forty-eight percent stake). The stock-for-stock merger resulted in Minebea issuing 30 million new common shares increasing the equity ownership in Minebea by stable shareholders by fifty-three percent. This defensive measure caused Trafalgar-Glen to commence proceedings in a Japanese court in an attempt to stop the planned merger. In March 1986, the court rejected Trafalgar-Glen's action in a preliminary ruling. The failure by Trafalgar-Glen to succeed in preventing the merger made it clear that it would be unable to gain control of Minebea. This resulted in negotiations between Minebea and Trafalgar-Glen to sell its remaining stake. By mid-April, Minebea announced that Trafalgar-Glen's stake had been purchased by an unnamed Japanese buyer at an undisclosed price. Trafalgar-Glen was reported to have made a significant profit as a result of fluctuations in the price of the yen which worked to their advantage. However, their ability to make a profit merely on the share price or to gain control of Minebea was thwarted. For a more complete summary of the facts, see KESTER, *supra* note 3, at 254-58.
they shared a number of characteristics that are typical of failed hostile takeovers in Japan: (1) the hostile takeover targets were both large, well-established Japanese companies listed on the TSE; (2) both targets had high asset values and languishing stock prices; (3) the acquirers were not part of Japan’s business establishment; (4) the management of the target companies relied on friendly stable shareholders and other defensive tactics to dilute the acquirer’s stake; and (5) management was ultimately successful in maintaining control.226

The Video Seller and Trafalgar-Glen cases reflect a wider trend of pre-bubble hostile share acquisitions in which management was able to maintain a firm grip on ultimate control. Every year from the late 1970s until the burst of the bubble in the late 1980s, there were several major share acquisitions of large listed Japanese companies by maverick Japanese investors with hostile intents.227 Although virtually every hostile share acquisition failed to remove control from management, many ended “successfully” for the acquirers as they “greenmailed” management of the target companies into repurchasing the shares they acquired at a premium in order to maintain their control.228 This trend was particularly pervasive from 1984 to 1988, during which Japan witnessed a rash of 23 successful greenmail transactions.229 None of these transactions removed ultimate control from entrenched managers, indicating that although these greenmail attempts “succeeded,” the threat they ultimately posed to the control rights of Japanese management was marginal.

Koshin’s acquisition of Kokusai Kogyo in December 1988 is the only case during the entire pre-bubble era in which a hostile acquirer successfully (albeit temporarily) removed ultimate control from incumbent management.230 However, upon closer examination, even this supposed hostile takeover is evidence of the inability of hostile acquirers to remove successfully ultimate control from incumbent Japanese management.231

Early in 1989, immediately following Koshin’s supposedly “successful” hostile takeover, the transaction was mired in criminal allegations related to Koshin’s on-market acquisition of the target’s shares. The allegations led

226. Id. The Trafalgar-Glen case is also notable because the target’s defensive measures were unsuccessfully challenged in court.
227. Id. at 247-48.
228. Id. at 237-62.
229. Id. at 247-48.
231. Arguably, this makes Koshin’s acquisition of Kokusai Kogyo the only successful hostile takeover of a major corporation in postwar Japan.
Japanese regulators to indict numerous parties involved in the takeover on charges of insider trading, stock price manipulation, violations of banking regulations, and tax fraud. Under the pressure of this enormous scandal, within a few months of this "successful" hostile takeover, Koshin lost control of Kokusai Kogyo's board. A little over a year later, Mitsuhiro Kotani, the infamous greenmailer who led Koshin's hostile takeover, was pressured to resign as Chairman of Kokusai's board and was later convicted of tax evasion charges in a related transaction.

Rather than serve as a threatening precedent to Japan's entrenched incumbent management, Koshin's disastrous and temporary takeover of Kokusai Kogyo did the opposite. It reinforced the image of hostile takeovers in the pre-bubble era as marginal players in corporate governance that were doomed to ultimate failure. During the recent recovery, this historical trend of failed hostile takeovers—which presented a marginal threat to the control of entrenched corporate management—continued.

In addition, as was the case during the recent recovery, prior to the burst of the bubble, Japanese courts played a significant role in regulating hostile takeover attempts. In the late 1980s, it was common for companies to issue shares to friendly shareholders as a defensive measure to dilute the hostile acquirer's stake. In several of these cases, hostile acquirers responded to these defensive measures by commencing injunctive proceedings, under Article

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233. On February 23, 1989, ten members resigned from Kokusai Kogyo's board. Seven of the directors that resigned had been placed on the board by Koshin in the December 1988 extraordinary shareholders' meeting in which Koshin removed ultimate control from incumbent management by electing a majority of directors to the board. Following the resignation of Koshin's seven directors, Kokusai Kogyo's board was composed of 11 original members (i.e., those on the board prior to the takeover) and eight members placed on the board by Koshin. Thus, incumbent management had regained substantial control of Kokusai Kogyo. *10 Resign From Kokusai Kogyo Board*, JIJI PRESS TICKER, Feb. 23, 1989.

234. KESTER, *supra* note 3, at 17; *Corporate Raider Given Suspended Sentence*, ASAHI NEWS SERV., May 19, 1993. In addition to Koshin's hostile takeover attempt being seen as a disaster because it was mired in scandal, it was also viewed to have had disastrous economic consequences for Kokusai Kogyo. *Kokusai Kogyo Hurt By Koshin's Buyout Attempt*, JIJI PRESS TICKER, June 14, 1991.

235. In his article in 2000, Minoru Tokumoto, discusses four cases in the late 1980s in which the court issued judgments in response to proceedings commenced in reaction to defensive measures implemented by a target company in the context of a hostile takeover attempt. Tokumoto, *supra* note 218.

280-10 of the *Commercial Code*, to suspend the issuance of shares by the target company.\textsuperscript{237}

In the late 1980s, as a result of a number of cases being brought before the court, a judicial test was developed for determining the circumstances under which target management could issue shares to friendly shareholders. According to this test, if the primary purpose of the issuance were to raise capital for the target company then the court would not suspend the issuance.\textsuperscript{238} The jurisprudence surrounding this test, which came to be known as the "primary purpose test", illustrates that the involvement of Japanese courts in hostile takeover battles was also not a novel feature of the recent recovery.\textsuperscript{239}

Failed hostile takeover attempts, and the court's role in policing them, did not end with the burst of the bubble. In November 1989, just as the bubble was about to burst, T. Boone Pickens, a Texas billionaire and infamous American corporate raider, commenced a high profile hostile takeover attempt against Koito Manufacturing, a parts supplier and member of the Toyota *keiretsu*.\textsuperscript{240} The Pickens-Koito takeover battle began when Pickens, who was widely criticized by the Japanese business establishment, secretly acquired a twenty percent stake in Koito from a well-known Japanese greenmailer.\textsuperscript{241}

This sparked a two-year takeover battle that included an unsuccessful court action by Pickens to use his shareholdings to gain information about Koito's finances, complaints by Pickens to the United States Congress that Koito's stable shareholding relationships amounted to unfair trade practices and the refusal by Koito to allow Pickens any representation on the board.\textsuperscript{242} In 1991, Pickens finally admitted that he could not defeat Koito with its stable Toyota *keiretsu* shareholders and sold the shares he had acquired without a profit.\textsuperscript{243} As expected, Koito's management remained firmly entrenched.

In 1996, Japan experienced another high profile hostile takeover attempt when Masayoshi Son, of Softbank and Yahoo! fame, joined forces with Rupert Murdoch, the Australian media baron and takeover mogul, to acquire TV Asahi, one of Japan's five main private broadcasters.\textsuperscript{244} Similar to T. Boone Pickens' attempt, the hostile takeover attempt by Son and Murdoch was "widely abhorred by the [Japanese business] establishment".\textsuperscript{245} After Son and Murdoch managed to acquire a twenty-one percent stake in TV Asahi, the

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\textsuperscript{237} See Tokumoto, *supra* note 218, at 5-11; see also Martin, *supra* note 220, at 55.

\textsuperscript{238} Tokumoto, *supra* note 218, at 4.

\textsuperscript{239} See 2005 CORPORATE VALUE REPORT, *supra* note 8, at 13.

\textsuperscript{240} Pauline C. Reich, *T. Boone Pickens and Corporate Governance in Japan: A Retrospective View of Three Sides of the Story and Recent Developments*, 27 L. IN JAPAN 27 (2001).

\textsuperscript{241} Id. at 29.

\textsuperscript{242} See id. at 29-36.

\textsuperscript{243} See ibid, *supra* note 14; Reich, *supra* note 240, at 31-33.

\textsuperscript{244} *Media Mould-Breakers*, CAMPAIGN, Mar. 24, 2006.

\textsuperscript{245} Id.
entire Asahi media group rallied around TV Asahi. Three months later, Son and Murdoch "cried uncle," selling their TV Asahi shares to Asahi Daily Shimbun (the group's daily newspaper) at no profit. The control of TV Asahi's management was never seriously threatened by the failed hostile takeover attempt.

The pervasiveness of failed hostile takeover attempts prior to the burst of the bubble and during the lost decade demonstrates that they were not a novel feature of the recent recovery. The court's involvement in regulating Japan's lackluster hostile takeover regime is also not new. Indeed, even claims by experts that failed hostile takeover attempts represent a revolution in Japanese corporate governance are not novel.

In 1991, Carl Kester, in his leading book on Japanese takeovers, claimed that failed hostile takeovers suggested a dramatic shift in Japanese corporate governance towards the American hostile takeovers-based model. Kester also predicted, based on the failed hostile takeover attempts of the 1970s and 1980s (particularly, Video Seller and Trafalgar-Glen), that Japan would develop "a newly active market for corporate control" that would "no doubt" feature a "few surprising and notable successful hostile takeovers". As almost two decades have passed since Kester published his book and there have been no "surprising [or] notable successful hostile takeovers", his predictions are obviously incorrect. The inaccuracy of Kester's predictions further casts doubt on similar, more recent, predictions by experts that "novel" hostile takeover attempts during the recent recovery represent a dramatic shift towards the American governance model.

In sum, the history of failed hostile takeovers by maverick investors prior to the recent recovery is important because it illustrates that the hostile takeover attempts that occurred during the recent recovery were not novel. Aggressive investors attempting to exploit asset rich companies with floundering stock prices have long been a part of Japanese corporate governance. The use of defensive measures and court actions in the context of these hostile takeover battles is also nothing new. Even attempts by experts to rely on failed hostile takeover attempts as evidence of the arrival of an American-style market for corporate control have a long history. Far from being "unthinkable," the failed hostile takeover attempts during the recent recovery and the familiar predictions by experts that these mere attempts suggest a dramatic shift in

246. Id.
247. Nakamoto, supra note 175.
248. In 1991, Kester, after admitting the failure of two of Japan's most celebrated hostile takeover attempts, posits that although "ultimately, both attempts failed to win control of the companies targeted...surprising inroads made in each case demonstrates the extent to which the Japanese market for corporate control has changed and foreshadows the more frequent use of Anglo-American tactics in future battles for corporate control of Japanese companies." KESTER, supra note 3, at 239.
249. Id. at 18, 239.
Japanese corporate governance were completely predictable.

C. The History of Failed Hostile Takeovers Continued During the Recent Recovery

The continued history of failed hostile takeovers during the recent recovery created a serious problem for experts who were intent on demonstrating that Japan developed a hostile takeovers market reminiscent of the United States in the 1980s. This led many experts to exaggerate the significance and pervasiveness of hostile takeovers during the recent recovery. In some cases, experts reported hostile takeovers when none existed. In other cases, overly exuberant pundits prematurely claimed that “Japan’s first successful hostile takeover was nearing completion,” only to see the hostile bid soundly defeated in traditional fashion. In yet other cases, a number of experts accurately acknowledged the persistent failure of hostile takeovers during the recent recovery, but then erroneously claimed that these failures were of “epoch-making significance”; the “nail in the coffin for . . . old Japan Inc.”; and marked “the advent of an era of hostile takeovers [in Japan].” As in the past, failed hostile takeovers merely reconfirmed that Japanese management, not shareholders, maintained a firm grip on corporate control—precisely the opposite of the dramatic shift in Japanese corporate governance that many experts claimed these failed hostile takeovers to represent.

250. See supra note 30.


253. NIKKEI Dec. 11, 2006, supra note 24; see also Milhaupt, supra note 2, 2173-74, 2216.

254. Fackler, supra note 135.


256. Jackson and Miyajima suggest that in the 1990s firms faced new competitive pressure from “an active market for corporate control.” Without any successful hostile takeover bids, an active market for corporate control did not (and does not) exist in Japan. Jackson & Miyajima, supra note 79, at 9.
The Efficiency of Friendliness

Before examining the details of the most prominent failed hostile takeovers during the recent recovery, it is necessary to re-examine transactions that have been held out to be hostile takeovers, which upon closer inspection, were not. A number of experts who credit hostile takeovers with transforming Japanese corporate governance during the recent recovery cite the 1999 acquisition by Cable & Wireless ("C&W") of International Digital Communications ("IDC") and the 2000 acquisition by Boehringer Ingelheim ("B&I") of SSP as the beginning of Japan's "new era of hostile takeovers." Despite such claims, both of these transactions were friendly acquisitions that bared no resemblance to a hostile takeover.

One such example was C&W's acquisition of IDC. Although dubbed as one of Japan's first "successful hostile takeovers," it was nothing of the sort. In 1998, the early stages of the IDC transaction occurred when IDC, a Japanese international telecom company, tendered for advice on its upcoming sale. Almost everyone in the market saw the tender as a mere formality because it was widely assumed that IDC was destined to be bought by NTT, Japan's former state telephone monopoly. However, in March 1999, C&W, a British international telecom company, which was already a large stable shareholder of IDC, made a surprising offer to purchase it. IDC's board remained neutral throughout the balance of the transaction and offered no further recommendations.

IDC's board held an extraordinary meeting to consider the two competing offers and expressed its general preference for the specific terms of the NTT offer. Following IDC's board meeting, C&W revised the terms of its offer and significantly increased the premium of its bid on two occasions in response to counter offers made by NTT. IDC's board remained neutral throughout the balance of the transaction and offered no further recommendations. At no time did IDC's management-controlled board attempt to use any takeover

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257. See, e.g., Gilson, supra note 1, at 23; Hines et al., supra note 22, at n. 225; Matsuko, supra note 251, at 4; Weapons Needed to Fight Takeovers, NIKKEI Wkly., Sept. 27, 2004.

258. Hines et al., found that "Cable & Wireless succeeded in its hostile tender offer for IDC shares." Hines et al, supra note 22, at n. 225; see also Jackson & Miyajima, supra note 79, at 15; Matsuko, supra note 251, at 4. For a concise overview of the facts in the C&W case, see COLCERA, supra note 17, at 60-62, 109.

259. COLCERA, supra note 17, at 60-62, 109; Shareholder Power, ECONOMIST, Nov. 27, 1999 [hereinafter ECONOMIST Nov. 27, 1999].

260. ECONOMIST Nov. 27, 1999, supra note 259.

261. See id. In 1987, when IDC was established, C&W acquired a 17.69 percent stake in IDC since 1987. IDC's Board Votes in Favor of NTT's Takeover Offer, JAPAN TIMES, Apr. 15, 1999.

262. ECONOMIST Nov. 27, 1999, supra note 259.

263. COLCERA, supra note 17, at 110.


265. COLCERA, supra note 17, at 109.
defenses or suggest which bid its shareholders should support based on C&W’s revised offers. In fact, the only recommendations following C&W’s revised offers were from Toyota and Itochu, two of C&W’s major stable friendly shareholders, who publicly announced their decision to sell their 17.7 percent stake in IDC to C&W. In the end, a resounding 134 of IDC’s 141 major stable shareholders chose to tender their shares to C&W. C&W ultimately acquired control of IDC because its revised offers were unopposed by IDC’s management and supported by IDC’s stable friendly shareholders—precisely the opposite of a hostile takeover.

Like the IDC transaction, the acquisition in 2000 of SSP, Japan’s fourth-largest supplier of over-the-counter drugs, by B&I, a large German drug company, is also erroneously described as one of Japan’s “first successful hostile takeovers.” Despite these claims, from the outset, B&I’s acquisition lacked the hallmarks of a hostile takeover. B&I and SSP were long-time business partners, with SSP acting as the distributor for B&I’s products in Japan. B&I also had a seat on SSP’s board and was a significant stable shareholder of SSP, with a 19.6 percent stake—hardly the profile of a corporate raider.

In 2000, B&I made a successful unsolicited bid for a controlling stake in SSP, offering a forty-two percent premium to SSP’s shareholders. There is no evidence that the bid was hostile in nature. To the contrary, B&I actively assured investors that the bid was not hostile and SSP’s management remained neutral throughout the entire bid. B&I’s friendly relationship with SSP’s incumbent management is evident from the fact that B&I chose to leave all of SSP’s management in place after its acquisition was complete—something that does not always occur even in friendly takeovers.

Experts also refer to the 2004 Sumitomo Trust-UFJ dispute as evidence that

266. Id.
270. See Matsuko, supra note 251, at 4 (claiming that Boehringer Ingelheim’s acquisition of SSP was a successful hostile takeover). Similarly, BusinessWeek erroneously reported the Boehringer Ingelheim case as a successful hostile takeover. Neff, supra note 29; see also ECONOMIST Feb. 17, 2001, supra note 15. Even Japan’s highly regarded Corporate Value Study Group erroneously (and somewhat confusingly) labeled the transaction “an unfriendly takeover.” 2005 CORPORATE VALUE REPORT, supra note 8, at 14.
271. COLCERA, supra note 17, at 59.
273. Id.; Smith, supra note 252.
274. Smith, supra note 252.
275. Id.
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Japan developed a hostile takeovers regime during the recent recovery.276 Again, this claim is confused. The Sumitomo Trust-UFJ dispute did not even involve a hostile takeover bid, let alone a successful hostile takeover. The dispute, however, did involve an interesting contractual issue and competing merger bids between Japan’s largest banks, but that misses the point. It is simply misleading to portray the Sumitomo Trust-UFJ dispute as an “epoch changing” transaction that marked a new era of hostile takeovers in Japan.277

The facts in the Sumitomo Trust-UFJ case are straightforward. In May 2004, UFJ Holdings entered into a memorandum of agreement to sell its most profitable entity, UFJ Trust Bank, to Sumitomo Trust.278 A term of the agreement was that Sumitomo Trust had the exclusive right to acquire UFJ Trust Bank during a two-year period and that neither party could engage in discussions with third parties that could have interfered with the potential acquisition (“the no shop clause”).279 In July 2004, UFJ appeared to violate this “no shop clause” by having discussions with Mitsubishi Tokyo Financial Group (MTFG) about a transaction in which MTFG would acquire all of UFJ’s business operations, including UFJ Trust Bank.280

In response to the MTFG-UFJ discussions, Sumitomo Trust commenced legal proceedings to stop the MTFG-UFJ transaction on the basis that it breached the “no shop clause.”281 After Sumitomo Trust’s legal action failed, it publicly threatened to launch a hostile bid for UFJ. However, in the end, Sumitomo’s threat of launching a hostile takeover bid was just a threat. In the fall of 2005, the MTFG-UFJ merger closed and Sumitomo Trust did not launch a hostile takeover bid.282 Characterizing the MTFG-UFJ transaction as evidence of Japan developing a U.S.-style hostile takeovers market is simply inaccurate.283

If mis-describing friendly transactions or contractual disputes as hostile takeovers is confusing, then mistaking takeover bids with actual hostile takeovers compounds the problem. In a recent article, Ulrike Schaede, an Associate Professor of Japanese Business at the University of California, claims that “in 2005 a total of 53 successful hostile takeovers were recorded [in Japan]”.284 In reality, there was not a single successful hostile takeover in Japan in 2005. It is likely, therefore, that Schaede has confused takeover bids (many

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276. Milhaupt, supra note 2, at 2177-78.
277. See id. at 2173-74, 2177-84.
278. See id. at 2177-78.
279. See Id.
280. Id.
281. Id.
282. Milhaupt, supra note 2, at 2177-78.
283. Milhaupt uses the MTFG-UFG case to support his more general conclusion of “the emergence of a market for corporate control in Japan . . . .” Id. at 2182-83.
284. Schaede, supra note 251, at 32.
of which were not hostile) with successful hostile takeovers.\textsuperscript{285} As takeover bids in Japan do not even serve as a valid proxy for the threat of hostile takeovers (see next subsection below), these 53 cases do not lend support to her conclusion that hostile takeovers became a significant feature of Japanese corporate governance during the recent recovery.\textsuperscript{286} In another recent article, The Lawyer Magazine reports that, in August 2006, Japan experienced its "first-ever hostile takeover" when Oji Paper acquired Hokuetsu Paper Mills.\textsuperscript{287} As described in more detail below, Oji's bid for Hokuetsu was defeated. The claim by The Lawyer Magazine is simply wrong.

Despite the exaggerations, mis-descriptions and false claims by experts, there were several failed hostile takeover attempts that actually did occur prior to and during the recent recovery. These failed hostile takeovers are noteworthy because they illustrate the ability of entrenched Japanese management to defeat consistently hostile takeovers. In addition, they demonstrate that hostile takeovers are still largely launched by those outside of Japan's established business community and that relying on friendly stable shareholders is still a primary mechanism for incumbent management to defeat hostile attempts. In this sense, the failed hostile takeovers of the recent recovery are a continuation of the history of failed hostile takeovers in Japan over the past several decades.

In January 2000, Yoshiaki Murakami, a man described at the time as "a corporate raider" who preached "a very American sounding gospel of shareholders' rights and free markets," launched what many claim was Japan's first domestic hostile takeover bid.\textsuperscript{288} Through his takeover boutique, M&A Consulting ("MAC"), Murakami targeted Shoei Corporation, a little-known electronics and real estate company that was part of the Fuyo (Fuji Bank) keiretsu. Shoei's cumulative stock price of $66 million and $570 million in liquid assets made it characteristic of a significant percentage of companies on the TSE that made Western pundits repeatedly predict that a wave of hostile takeovers in Japan was inevitable.\textsuperscript{289}

On January 24, 2000, MAC made a tender offer for all of Shoei's outstanding shares, with a forty percent premium over the 1999 market price.\textsuperscript{290} Murakami's move made media headlines, but as an unwelcome outsider, he garnered little respect from Shoei's president, who refused to speak with

\textsuperscript{285} The total number of takeover bids in Japan in 2005 was 53—which is the same as the purported number of successful hostile takeovers reported by Schaeede. See RECOF's webpage for a chart displaying the number of takeover bids in Japan from 1972 until present, available at http://www.recof.co.jp [hereinafter RECOF CHART].
\textsuperscript{286} See Schaeede, supra note 251, at 32.
\textsuperscript{287} LAWYER Mar. 19, 2007, supra note 251.
\textsuperscript{288} TIME Feb. 7, 2000, supra note 173.
\textsuperscript{289} Id.
\textsuperscript{290} COLCERA, supra note 17, at 110.
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him.291 Despite the substantial premium offered, MAC’s bid failed miserably, accumulating only 6.5 percent of Shoei’s shares.292 The reason for the failure was predictable. In traditional fashion and unlike the American takeover market, stable and friendly shareholders gave unconditional support to existing management and refused to tender their shares to the “unwelcome bidder” regardless of the premium.293

In December 2003, the next widely publicized hostile takeover attempt took place when Steel Partners, an aggressive American buyout fund, attempted to takeover Sotoh, a wool fabric company, and Yushiro Chemical Industry.294 Both companies were extremely attractive takeover targets since their cumulative stock prices were lower than their liquidated asset values and they had significant cash holdings.295 Steel Partners, which already had a ten percent stake in each of the companies, made takeover bids for each company with a thirty percent premium over their previous closing prices.296

In both cases, incumbent management “immediately announced their opposition to the unsolicited bids and, as a defensive measure,” substantially increased their dividends.297 The substantial increase in dividends caused the share price of both companies to increase dramatically. As a result, Steel Partners’ hostile bids failed miserably because they no longer offered a substantial premium to shareholders.298 In 2005, after Sotoh’s management decided that the threat of a hostile takeover was no longer imminent they decreased dividends to pre-bid levels.299 The tactic used by Sotoh’s management to “pay off” its shareholders with a short-term dividend increase, to maintain their power, is reminiscent of Japanese managers using corporate funds to ‘pay off’ greenmailers in the 1980s.

In 2005, Livedoor’s failed hostile takeover of Nippon Broadcasting System (“NBS”) caused a media circus that rivaled any business story in recent memory.300 Public interest in the attempted hostile takeover was fueled by Livedoor’s flamboyant 32-year-old president and university dropout, Takafumi

291. The president of Shoei publicly declared that he did not “need to talk to every investor.” TIME Feb. 7, 2000, supra note 173.
292. COLCERA, supra note 17, at 110.
293. Lee, supra note 99.
294. See Milhaupt, supra note 2, at 2180-81.
295. See id. at 2180.
296. Id. at 2180-81.
298. See Milhaupt, supra note 2, at 2181.
299. In May 2005, Sotoh decreased its dividend back close to where it was prior to the Steel Partners bid claiming that “its takeover risks [had] receded now that the U.S. fund’s stake [had] dropped.” COLCERA, supra note 17, at 113-14.
Horie, who became a billionaire and cultural icon through a dotcom company he started named Livin’ on the Edge (later renamed Livedoor). Horie’s spiky-hair, “Cheshire cat” grin, silver-blue Ferrari, bikini-clad girlfriend and t-shirt and jeans business attire mesmerized the Japanese public. It seemed that Japanese people, especially the younger generation, could not get enough of this brash young entrepreneur taking on Japan’s corporate old guard who had fallen out of favor during the lost decade.

Experts and academics fell into the “Horie-hype” and pointed to Horie as evidence of a dramatic shift in Japanese corporate governance. Some experts posited that the day Horie launched Livedoor’s bid for NBS marked the “advent of an era of hostile takeovers” in Japan. Other experts claimed that Livedoor’s takeover attempt sparked “a revolution in [Japan’s market for] corporate control.” Some other experts even erroneously credited Horie with pulling off Japan’s first-ever successful hostile takeover before the Livedoor bid was even complete. In the end, similar to most other trends in Japan, the “Horie-hype” faded quickly. Livedoor’s hostile bid failed in traditional fashion with stable friendly shareholders coming to NBS’ rescue and Horie being disgraced by an accounting fraud and stock market manipulation conviction that sent him from his Roppongi Hills penthouse to the “Japanese big house.”

All ‘Horie-hype’ aside, the Livedoor case was simply another example of a maverick Japanese investor being defeated by incumbent Japanese management with help from friendly stable shareholders. The Livedoor case arose out of an unusual cross-shareholding relationship that existed between NBS and Fuji TV, which were both part of the same media conglomerate (the Fujisankei Communications Group). Fuji TV, Japan’s largest private television company, was technically controlled by NBS, a much smaller radio station, by virtue of the fact that NBS owned 22.5 percent of Fuji TV’s shares, while Fuji

301. Milhaupt, supra note 2, at 2181.
305. AUSTRALIAN Jan. 21, 2006, supra note 255; Livedoor May Have Opened Door to Era of Hostile Takeovers, JAPAN ECON. NEWSWIRE, Feb. 23, 2005.
307. Smith, supra note 252. Japan’s highly regarded Corporate Value Study Group, which drafted a report that was foundational in establishing Japan’s Takeover Guidelines, erroneously suggests in its report that Livedoor’s hostile bid was successful. See 2005 CORPORATE VALUE REPORT, supra note 8, at 14.
310. Alger, supra note 300, at 319.
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TV owned only 12.4 percent of NBS' shares. This created the perverse incentive for corporate raiders to target the much less valuable NBS to gain de facto control of Fuji TV.

To rectify this situation, on January 17, 2005, Fuji TV announced an all-cash offer for all of the outstanding shares of NBS. Fuji TV’s bid was below the market price for NBS shares, which (as explained below) was characteristic of takeover bids in Japan prior to and during the recent recovery. Despite the below market offer, the takeover bid was immediately approved by Fuji TV’s management, which was also predictable during Japan’s recent recovery.

However, unbeknownst to NBS and Fuji TV, during the tender offer period, Livedoor was secretly acquiring NBS shares in after-hours trading. On February 8, 2005, before Fuji TV’s tender offer period had expired, Livedoor made the shocking announcement that it had acquired 29.6 percent of NBS’ shares (bringing its stake up to thirty-eight percent) and intended to acquire the remainder. NBS responded quickly with defensive measures by announcing that it would issue warrants to Fuji TV, which if exercised, would dramatically increase NBS’ share capital by 140 percent and dilute Livedoor’s stake in NBS to less than twenty percent.

In response to NBS’ defensive actions, Livedoor sought an injunction from the court to stop the issuance of the NBS warrants. The fact that the warrants, if exercised, would have more than doubled NBS’ capital made it virtually impossible for NBS to argue convincingly that the “primary purpose” of the issuance was to raise capital and not to entrench management. Therefore, unsurprisingly, in light of the well-established “primary purpose test,” the Tokyo District Court granted NBS’ injunction, which was affirmed on appeal by the Tokyo High Court.

Livedoor’s court victory prompted Fuji TV’s management to fight back using traditional defensive tactics. Fuji TV called on its friendly stable shareholders to increase their NBS holdings and convinced Softbank

311. Id.
314. Alger, supra note 300, at 319. According to Hines, “although the Livedoor trades were legal at the time, many observers thought that such trading circumvented the tender offer rules, which generally require an acquirer to make a tender offer or purchase shares in the market after passing the one-third ownership threshold for target shares. So the supposedly heroic Mr. Horie was able to mount his bid in ways that would be considered outrageous in London or New York: he built up his thirty-five percent stake in NBS in off-market trading, diluted his own investors’ shareholdings without consulting them and never offered a standard price to all NBS shareholders.” Hines et al., supra note 22, at 375-76.
315. Alger, supra note 300, at 319; Milhaupt, supra note 2, at 2179.
316. Alger, supra note 300, at 319; Gruener, supra note 168, at 879; Michiyoko Nakamoto, A Takeover Battle Launched by Upstart Livedoor Is a Test of How Much Big Corporate Groups Can Protect Themselves Against Unwanted Attention, FIN. TIMES, Mar. 22, 2005.
317. Gruener, supra note 168, at 879.
318. Id. at 878-79; Alger, supra note 300, at 320.
Investment to borrow fifteen percent of Fuji TV's shares from NBS—making Softbank Investment Fuji TV's largest shareholder.\(^{319}\) As a result, Livedoor could no longer gain *de facto* control over the extremely valuable Fuji TV by controlling NBS. In addition, NBS' management received crucial support from its lifetime employees, as ninety percent of them signed a public statement supporting NBS' incumbent management over Horie and Livedoor.\(^{320}\)

In April 2005, in an act that was tantamount to admitting defeat, Livedoor sold its NBS shares to Fuji TV at a marginal profit, which was just enough to allow Horie to "save face."\(^{321}\) In the end, Livedoor was defeated because, in traditional fashion, stable and friendly shareholders rallied around incumbent management, "demonstrating that the era of a truly free stock market [was] still a long way off" in Japan.\(^{322}\) In addition, the defeat emphasized that Japan's unique corporate governance, embodied here by lifetime employees, renders dubious any predictions of hostile takeovers that find support from American precedent.

In the year following Livedoor's failed hostile takeover, there were a number of other hostile takeover attempts. These attempts received far less coverage and were universally unsuccessful.\(^{323}\) However, in the summer of 2006, hopeful hostile takeover pundits emerged again when Oji Paper launched its hostile takeover bid for Hokuetsu Paper Mills. Oji's bid reigned familiar claims of an "epoch-making" event that was sure to spark a "wave" of successful hostile takeovers in Japan.\(^{324}\) Predictably, yet again, Oji's bid failed in traditional fashion with friendly stable shareholders rescuing Hokuetsu's management at the expense of individual minority shareholders.\(^{325}\)

The particular facts in the Oji case are worth examining because they illustrate that, even as the recent recovery was coming to an end, incumbent


\(^{320}\) Id.

\(^{321}\) Id.

\(^{322}\) Id. at 11-13. An interesting footnote to the Livedoor case was that the financing received by Livedoor for the takeover was from the American investment bank, Lehman Brothers. This fact caused an enormous amount of controversy and made many members of Japan's business establishment consider the Livedoor takeover as an American driven takeover that had no place in corporate Japan. This argument was strengthened when Horie was arrested and convicted. *See* Alger, *supra* note 300, at 319-321.

\(^{323}\) Some of the more prominent failed hostile takeovers following Livedoor's failed takeover attempt were as follows: in July of 2005, Yumeshin Holdings' hostile takeover bid for Japan Engineering Consultants. *Id.* at 319; in November 2005, Rakuten's hostile takeover bid for Tokyo Broadcasting System failed, Hines et al., *supra* note 22, at 382-84; in May 2006, MAC's hostile takeover attempt of Hanshin Electric Railway failed when Hanshin was acquired by Hankyu Holdings, a friendly shareholder, Hines et al., *supra* note 22, at 834-35; in February 2006, Don Quijote failed in its hostile takeover bid for Origin Toshu, when Origin Toshu's shares were acquired by a friendly shareholder, Aeon, Hines et al., *supra* note 22, at n. 225.


\(^{325}\) *See* Alford, *supra* note 22; William Pesek Jr., *Japan's Barbarians Within*, INT. HERALD TRIB., Aug. 6, 2006.
Japanese management still maintained an iron grip on their *de facto* corporate control. In May 2006, the event that triggered Oji’s unsolicited takeover bid occurred when Hokuetsu decided to expand the production capacity in its Niigata plant, posing a serious threat to profits in Japan’s already saturated paper industry. On July 3, 2006, in response to this threat, Oji’s management informed Hokuetsu that it intended to acquire Hokuetsu and provided its plan for a post-merger integration. As expected, Hokuetsu’s management quickly began working behind the scenes to rally its friendly and stable shareholders to ward off Oji’s unwelcome takeover attempt.

On July 21, 2006, Hokuetsu’s board put its defensive measures into action. The board decided that it would issue Mitsubishi, a friendly stable shareholder, 50 million shares at the discount price of 607 yen—which was approximately five percent below the previous closing price and ten percent below the high earlier in the year. The share issuance would provide Mitsubishi with a twenty-four percent stake in Hokuetsu’s expanded capital and ensure that Hokuetsu’s management had a large block of stable friendly shares to protect them against Oji’s attempted hostile takeover. At the same meeting, the board voted itself a poison pill in the form of equity warrants issued to friendly stable shareholders, including Mitsubishi, which were exercisable in the event that Oji (or any other unwelcome acquirer) made an unsolicited tender offer.

As to be predicted, Hokuetsu’s defensive measures ensured the entrenchment of Hokuetsu’s incumbent management, but blatantly disregarded minority shareholders. Without a seat on Hokuetsu’s board, the average shareholder would have had no way of knowing that twenty-four percent of their company had been offered to Mitsubishi at a significant discount, that they were to be diluted by sixteen percent, and that a poison pill protected management. Minority shareholders also received scant protection from the so-called “independent committee” that approved the poison pill, as it was

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331. *Id*
332. *Id.*
333. According to Hines et al.:

> at the present time, special committees are most often used when a Japanese company adopts a rights plan. A customary example is when, as part of the announcement of a rights plan, a Japanese company will require that activation and cancellation of the rights plan be determined by the board of directors that "assigns maximum value to the recommendations" of a special committee. In contrast to the customary practice in the United States, in Japan the members of the special committee are not only directors of the target company, but may also include independent statutory auditors or outside advisors, such as legal counsel.

made up of two retired auditors who had previously worked for Hokuetsu and a Shinto priest—hardly a model for minority shareholder protection. The TSE was similarly left in the dark by Hokuetsu's management-dominated board, which conveniently failed to mention Oji’s takeover offer when it gave notice to the TSE (as required by the New TSE Listing Rules) about the board’s plan to institute the poison pill.

Finally, on July 23, 2006, after spending more than two weeks surreptitiously building an impenetrable barrier of takeover defenses, Hokuetsu’s management formally rejected Oji’s takeover offer. Oji’s president responded by publicly announcing that if Hokuetsu cancelled its planned placement of shares with Mitsubishi, Oji would make an on-market offer for 50.1 percent of Hokuetsu’s shares at the premium price of 860 yen—thirty-five percent above the previous closing price. The stock market quickly responded to Oji’s potential offer by driving up Hokuetsu’s shares to 825 yen.

At this point, from an American shareholders’ rights perspective, the planned placement by Hokuetsu’s board of a quarter of the company with Mitsubishi for 607 yen per share, which now stood at a whopping twenty-six percent discount to the current market price, appeared unthinkable. However, Hokuetsu’s board would make its decision in Tokyo, not Delaware. So predictably, the placement of Hokuetsu’s shares in Mitsubishi went through as planned.

Then, when it seemed that the shenanigans of Japanese management could not get any worse, Oji was blindsided again when Nippon Paper Group announced that it had acquired an 8.5 percent stake in Hokuetsu to help block the Oji bid. Even more shocking, Nippon Paper’s management-dominated board paid approximately 800 yen for the same shares that Mitsubishi was being handed for 607 yen—knowing full well that when Hokuetsu placed its shares with Mitsubishi it would significantly dilute Nippon Paper’s stake. For good measure, Nippon Paper’s board also conveniently forgot to comply with the five percent reporting rule when it acquired its 8.5 percent blocking stake in Hokuetsu.

This is where claims that Japan’s hostile takeovers market dramatically

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335. Alford, supra note 22.
336. See NIKKEI Sept. 4, 2006, supra note 327.
337. See Alford, supra note 22; Wright, supra note 27.
338. Alford, supra note 22.
341. Alford, supra note 22.
342. Id.
changed during the recent recovery begin to unravel. According to such claims, in the dramatically changed environment of the recent recovery, Japanese shareholders should have challenged Hokuetsu’s unreasonable defensive measures in court. Conversely, Hokuetsu’s friendly shareholders should not have sacrificed shareholder value in their own companies merely to save Hokuetsu’s incumbent management. In Milhaupt’s words, during the recent recovery it was “no longer considered acceptable [for Japanese boards] . . . to support incumbent management . . . regardless of the financial consequences to their own shareholders”. Based on such claims, there should have been a tirade of litigation challenging the “Shinto priest approved” poison pill; the sale of a quarter of Hokuetsu to Mitsubishi at an unreasonable discount; and the purchase of soon-to-be-diluted shares at an unjustifiable premium by Nippon Paper’s management-dominated board.

However, what “should have” happened, based on the predictions of hopeful M&A pundits, did not. There was not a single legal proceeding commenced in the Oji-Hokuetsu case. The brazen defensive measures by

343. There have been a myriad of claims from experts that Japan developed a vigorous, American-style, hostile takeovers market during the recent recovery. Milhaupt confidently proclaimed that “hostile takeovers have arrived in Japan.” More specifically, Milhaupt claims that in Japan’s new hostile takeovers market, it is “no longer considered acceptable [for Japanese boards] . . . to support incumbent management . . . regardless of the financial consequences to their own shareholders.” Milhaupt also claims that the events during the recent recovery suggest “that the incidence of corporate litigation may increase significantly as market actors test the validity of defensive measures.” Milhaupt, supra note 2, at 2171, 2173, 2186, 2202. Many others have echoed Milhaupt’s claims. Ulrike Schaede, based on a review of changes in Japanese corporate governance during the recent recovery, including purportedly successful hostile takeovers, predicted that “shareholder rights have been greatly strengthened. So crucial are these changes that they constitute a 'strategic inflection point' meaning that the old ways of doing things have been irreversibly transformed.” Schaede, supra note 251, at 5. Gruener similarly claims that, based on the circumstances of the recent recovery, “Japan is experiencing a market for corporate control for the first time” and that “the American way of thinking—management for shareholders—is becoming widely accepted by Japanese managers. They are starting to try to enhance cash flow to shareholders and maximize share prices.” Gruener, supra note 168, at 873, 895. Even based on a few friendly takeovers during the early part of the recent recovery, Gilson predicted, that “the long wait for hostile transactions in Japan may be approaching its end.” Gilson, supra note 1, at 22. Business reports have been no less hopeful than academics. According to the Economist Intelligence Unit, as a result of Horie’s failed takeover of Livedoor, “a revolution in corporate control is under way in Japan . . . with one surprise maneuver the market for corporate control among Japanese firms seemed to have finally opened.” EIU 2005, supra note 15, at 7. Others claim that the Livedoor failure: (1) made “Japanese companies suddenly [come] to the realization that they should reorganize their operations, strengthen their management and, ultimately, increase shareholder value”; (2) shook up “austy corporate culture, championed investors' interests and accelerated Japan's transformation; and (3) “laid the groundwork for a more dynamic M&A market and better corporate governance in Japan by highlighting the significance of shareholder value, clarifying the rules and educating the public on the issues.” Caryl, supra note 208; Kingston, supra note 17; Nakamoto, supra note 175. METI even took action based on the assumption that, during the recent recovery, Japan had developed an American-style hostile takeovers market. Osugi, supra note 12. Even the Oji bid itself was claimed to “signal the coming of a new era” of hostile takeovers. Nikkei July 31, 2006 supra note 24.

344. See Milhaupt, supra note 2, at 2202.
345. Id. at 2186.
346. Alford, supra note 22.
347. See id.
Hokuetsu’s management and its friendly stable shareholders produced not a peep from nascent shareholders. Even Hokuetsu’s foreign shareholders, who held twenty-five percent of the company, would not take the risk of challenging the defensive measures of Hokuetsu’s corporate old guard.  

Finally, on August 30, 2006, without a legal action in sight, over thirty percent of Hokuetsu in the hands of two companies that were not on the share register a month before, and with a “Shinto priest approved” poison pill in place, Oji conceded defeat. Oji’s “epoch-making” bid for 50.1 percent of Hokuetsu, which received rave reviews from the international business community for making impeccable business sense, managed to net Oji a paltry 5.25 percent of Hokuetsu’s shares—not exactly a menacing threat to Hokuetsu’s entrenched management. However, Oji’s hostile attempt did achieve one thing. It made Oji a pariah in Japan’s “old school” paper industry and left the Japanese bank that supported Oji’s bid wondering why it ever went out on a limb to do so.

The Oji case occurred as Japan’s remarkable 5-year recovery was ending and its economy was transitioning into an era of sustained growth. This example clearly illustrates that not much changed during the recent recovery as hostile takeovers continued to play a marginal role in corporate restructuring. This is confirmed by a survey of Japanese management shortly after the Oji bid, which reported that seventy-seven percent of Japanese executives said that they would not consider attempting a hostile takeover. However, in the same survey, ninety-three percent expected friendly corporate acquisitions to continue to increase in Japan. This suggests that the “efficiency of friendliness,” which drove the recent recovery, may also continue to drive Japan’s post-recovery economic growth. Indeed, since Oji’s bid failed, the market for friendly takeovers in Japan has remained strong and there is yet to be a successful hostile takeover bid in Japan.

D. Japanese Takeover Bids Do Not Serve as a Reliable Proxy for the Threat of Hostile Takeovers

A technical point that must be addressed before moving on is the claim by
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some experts that an increase in the number of takeover bids in Japan during the lost decade and recent recovery demonstrates that Japan developed, or is developing, an American-style hostile takeovers regime.356 This claim would be accurate if takeover bids in Japan were tantamount to takeover bids in the United States. However, they are not. The significant discrepancy between what is considered a takeover bid in Japan and the United States makes conclusions based on comparisons between them erroneous.

In the United States, the number of takeover bids has come to be viewed as a proxy for the threat level of hostile takeovers.357 This is because, contrary to mergers, takeover bids allow bidders to bypass management by making an offer directly to target shareholders.358 This allows takeover bidders to assume control of target companies without management’s approval (i.e., via a hostile takeover) and then to replace unskilled or underperforming management to improve company performance.359

During the vigorous hostile takeovers market in 1980s America, takeover bids were the primary means for initiating and executing hostile takeovers.360 In the 1980s, the United States was an epicenter for hostile takeovers, as over half of all major American companies received hostile takeover bids.361 In 1988 alone, there were over 200 hostile takeover bids and 85 successful hostile takeovers.362 As such, during the 1980s, the threat of a hostile takeover bid and a subsequent overhaul of management was a real prospect for every CEO of a listed American company. Many experts claim that, in the late 1980s, this ex ante threat of being subject to a hostile bid, with the real prospect of being taken over, forced American executives to focus on maximizing shareholder value and reducing agency costs, which successfully drove the restructuring of corporate America.363

356. Enrico Colcera, in his book, which attempts to prove that during the recent recovery Japan moved towards an American-style hostile takeovers regime, relies on the increase in the number of takeover bids as part of his evidence. Colcera also suggests that comparing the raw number of takeover bids in Japan and the United States (as well as other countries) illustrates the development of Japan’s market for corporate control. However, Colcera ultimately concludes that although this demonstrates that Japan has decidedly moved towards an American-style market for corporate control, at present, Japan has a “hybridized model.” COLCERA, supra note 17, at 48-52. Ulrike Schaede, in two separate articles, erroneously equates takeover bids with successful hostile takeovers. Schaede then proceeds to use the evidence of an increase in the number of takeover bids to support her broader conclusion that Japan has abandoned its governance system and adopted an American-style market-based monitoring system. See Schaede, supra note 16, at 22; Schaede, supra note 251, at 32.

357. See Baird & Rasmussen, supra note 1, at 1243; Holmstrom & Kaplan, supra note 2, at 125.


359. Id. at 3.

360. Id. at 1.

361. Holmstrom & Kaplan, supra note 2, at 125.


363. According to Roe, “hostile takeovers can control agency costs in public firms. The stock price of mismanaged firms sags, and takeover entrepreneurs or managers at other firms buy up the stock cheaply, improve the target firms' operations, and thereby profit. While the debate in the 1980s in the
In Japan, prior to 1990, there were virtually no takeover bids. From 1990 until 1997, takeover bids increased modestly to less than 10 bids per year. However, since 1997, there has been a substantial increase in the number of takeover bids from about 20 in 1999, 30 in 2001, 40 in 2004, and 50 in 2005. According to American precedent, this increase in takeover bids should have significantly increased the threat of hostile takeovers in Japan. Indeed, several experts have pointed to the increase in the number of takeover bids as evidence that the threat of hostile takeovers significantly increased in Japan during the lost decade and recent recovery. However, comparing Japanese and American takeover bids is like comparing "apples and oranges." Compared to their American counterparts, Japanese takeover bid rules are extremely broad. In Japan, with only a few limited exceptions, a proposed purchase of shares will be considered a takeover bid whenever shares are acquired outside of the securities market. In the United States, for a proposed purchase of shares to be considered a takeover bid it generally must meet eight criteria including that the offer price is higher than the market price (i.e., the offer includes a 'premium').

According to two studies conducted on takeover bids in Japan in the post-bubble era, almost half of the takeover bids had an offer price below the market price (i.e., a "negative premium"). Therefore, on this basis alone, half of the post-bubble takeover bids would not be considered takeover bids under United States law. More importantly, these negative premium bids present absolutely no ex ante threat to management to maximize shareholder value or control agency costs. To the contrary, management may feel they can allow the company's share price to decline if there are negative premium bids in the market.

A related peculiarity in Japanese takeover bids is that the average premium offered to shareholders was (and is) extremely low compared to the premium

United States was wide as to whether this was the primary goal and effect, surely it was one effect, and a shareholder-oriented takeover policy would cull out the extraneous causes and effects." Roe, supra note 2, at 558; see also, Burkart & Panunzi, supra note 2, at 9, 24; Holmstrom & Kaplan, supra note 2, at 125.

364. KESTER, supra note 3, at 99; Milhaupt & West, supra note 3, at 36.
365. COLCERA, supra note 17, at 49; see RECOF CHART, supra note 285.
366. COLCERA, supra note 17, at 49.
369. Id.
370. According to Dale Oesterle, "the factors that indicate a tender offer are: (1) an active and widespread solicitation of public shareholders, (2) for a substantial percentage of the issuer's stock, (3) at a premium over prevailing market price, (4) on firm rather than negotiable terms, (5) contingent on the tender of a fixed minimum number of shares and with a ceiling of a fixed maximum number of shares, (6) open for a limited period of time, (7) putting pressure on offerees to sell their stock, (8) and using public announcements of the purchasing program." Dale A. Oesterle, The Rise and Fall of Street Sweep Takeovers, 1989 DUKE L.J. 202, n.92.
371. Komoto, supra note 200, at 10; Milhaupt & West, supra note 3, at 17.
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offered to shareholders in American takeover bids (and in bids in all other countries). In the United States, the average premium offered to shareholders in takeover bids is about forty-five percent above the market price.\textsuperscript{372} In Japan, during the lost decade, the average premium offered to shareholders in takeover bids was \textit{minus} 4.72 percent.\textsuperscript{373} According to one study that examined takeover bids from 1990 to 2002, Japan held the unique distinction of being the only country in the world that had an average negative bid premium.\textsuperscript{374} Even during the recent recovery, when premiums were said to have increased, the average premium offered was a modest ten percent, which is well below the forty-five percent offered in the United States.\textsuperscript{375}

Takeover bid premiums in Japan were considerably lower than in the United States (and all other developed countries) because a significant portion of Japanese takeover bids involved friendly pre-negotiated deals between bidders and target companies.\textsuperscript{376} In these so-called “takeover bids,” the offer price is arranged between the acquirer and main shareholders (with approval from ‘target’ management) prior to the offer being made and there is no competition between potential acquirers. This is in sharp contrast to American takeover bids where prearranged friendly offers to a single bidder, which normally have a small or negative premium, are not considered takeover bids.\textsuperscript{377} These low premium prearranged takeovers, which predominated in Japan during the lost decade and recent recovery, do nothing to increase the threat of hostile takeovers. In fact, they are welcomed by incumbent management as they may present an opportunity to be rescued from hidden liabilities (which may be the reason for the negative premium bids) that have not been disclosed to the market.\textsuperscript{378}

Even the rare Japanese takeover bids that included premiums similar to typical American takeover bids have failed.\textsuperscript{379} Again, this is in contrast to the United States, where about thirty-five percent of hostile bids succeed, and the European Union, where fifty percent of hostile bids are successful.\textsuperscript{380} Obviously, with a zero percent success rate, even takeover bids that do offer a substantial premium, will not pose the same level of threat as takeover bids in the United States or European Union, where there is a significant chance that a

\textsuperscript{372} Rossi & Volpin, \textit{supra} note 2, at 282.
\textsuperscript{373} Milhaupt & West, \textit{supra} note 3, at 17.
\textsuperscript{374} Rossi & Volpin, \textit{supra} note 2, at 282.
\textsuperscript{376} Komoto, \textit{supra} note 200, at 11.
\textsuperscript{377} \textit{Id.} at 10.
\textsuperscript{378} \textit{Id.} at 12-13.
\textsuperscript{379} In fact, less than twenty percent of bids during the lost decade had premiums that were comparable to American levels. \textit{Id.} at 12.
\textsuperscript{380} 2005 \textit{CORPORATE VALUE REPORT}, \textit{supra} note 8, at 12.
takeover bid will result in a successful hostile takeover.

Finally, even if all of the significant differences between Japanese and American takeover bids are ignored, the total number of takeover bids in the United States during the late 1980s still dwarfs the number in Japan during the lost decade and recent recovery. In the United States, during the last five years of the 1980s, there was approximately three times the number of takeover bids as in Japan during the lost decade and recent recovery—which lasted over 15 years.\(^3\) Of course, this overlooks a significant percentage of so-called Japanese “takeover bids” which were not a proxy for hostility in the market.

In sum, it is undeniable that there was an increase in takeover bids in Japan during the lost decade and recent recovery. However, this increase is not comparable to that of the United States in the 1980s—in either the nature or frequency of the bids. This is because a significant percentage of Japanese “takeover bids” were friendly, negotiated deals with low or negative premiums. In addition, all of the bids offering premiums equivalent to those in the United States failed. As such, the raw number of so-called “takeover bids” in Japan during the lost decade and recent recovery is not a reliable proxy for the threat of hostile takeovers. If anything, especially during the lost decade, it is more likely that Japanese takeover bids acted as a proxy for perversity in the market (i.e., stronger companies rescuing weaker ones with undisclosed liabilities, which may explain negative premium bids) than as threats of hostile takeovers.\(^2\)

E. Japanese Managers Did Not React Swiftly to the Purported Threat of Failed Hostile Takeovers

Another way to gauge the effect of failed hostile takeovers on corporate governance during the recent recovery is to attempt to measure the subjective threat felt by Japanese managers as a result of failed hostile takeovers. From a corporate governance perspective, the threat of hostile takeovers only becomes significant if it is serious enough to influence managerial behavior.\(^3\) A clear indication that management perceives the threat of hostile takeovers as serious is when management takes steps to protect itself against hostile takeovers. During the 1980s, the serious threat of hostile takeovers in the United States

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381. In the United States, there were 1,032 hostile bids from 1985 to 1990. Lucian Arye Bebchuk et al., The Powerful Anti-takeover Force of Staggered Boards: Theory Evidence and Policy, 54 STAN. L. REV. 887, 925 (2002). In Japan, there were less than 300 takeover bids between 1990 and 2005. COLCERA, supra note 17, at 49.

382. For an overview of perverse incentives in the lost decade, see Puchniak, supra note 49.

383. Many scholars suggest that fear of hostile takeovers drove Japanese companies in the 1960s to adopt cross-shareholding structures. Hideaki Miyajima & Fumiaki Kuroki, The Unwinding of Cross-Shareholding in Japan, in CORPORATE GOVERNANCE IN JAPAN 79, 85 (Masahiko Aoki et al. eds., 2007). If this is the case, then the unwinding of cross-shareholding during the lost decade and recent recovery would suggest that the fear of hostile takeovers was insignificant compared to the other economic problems that companies faced.
drove managers to take a number of defensive actions. Two of the most significant actions were adopting poison pills and increasing the prominence of independent directors on American boards—both of which were effective in guarding against hostile takeovers.384

In November 1985, the Delaware Supreme Court upheld a company’s right to adopt the poison pill as a takeover defense.385 Shortly after the court’s “authorization of the pill,” over 1000 American companies adopted this defensive technique. Furthermore, by the mid-1990s, over sixty percent of all listed American companies had adopted the pill.386 This is definitive evidence that, in the late 1980s, the threat of hostile takeovers was serious enough to drive managerial action in the majority of American companies.

Prior to 2001, the poison pill was not available under Japanese law. In 2001, a Commercial Code amendment made a version of the poison pill technically available in Japan.387 However, despite efforts by large law firms to market the pill and predictions by experts that the pill may be widely adopted, no Japanese companies adopted it.388 This failure to adopt the pill may have been because, although it was technically available, its legal status was still uncertain.389

Then, in 2005, the government responded to the uncertainty of the legality of the poison pill by releasing the Takeover Guidelines which “officially sanctioned” the poison pill and imported Delaware takeover jurisprudence into Japan.390 Both the government and large law firms actively encouraged listed companies to adopt the “officially sanctioned” poison pill.391 Based on American experience in the 1980s, it was assumed that “officially sanctioning” the pill would cause a wave of companies to adopt it.392 Central to this assumption was the erroneous belief that Japanese managers were seriously threatened by hostile takeovers—regardless of the fact that all hostile takeover bids had failed.

However, despite the 2001 Commercial Code amendment, the “official
sanctioning” of the pill, and the government and law firms’ attempts to market the pill, the adoption of the pill has, at best, been “limited and gradual”. In 2005, only eight out of Japan’s 4,000 listed companies adopted the poison pill at their annual general shareholders’ meeting. Even by 2006, as the recent recovery ended and Japan’s period of sustained growth commenced, still less than two percent of Japan’s listed companies had adopted the pill. In sum, during the recent recovery, very few Japanese managers feared hostile takeovers enough to implement the poison pill. This empirical evidence also calls into question predictions by experts who expected Japan to rush to adopt the pill based on the past experience in American corporate governance during the 1980s.

Also in the 1980s, the rise of the poison pill in the United States was accompanied by an increase in the prominence of independent directors on American boards. Delaware jurisprudence made the independence of boards a central criterion for justifying the appropriateness of defensive actions taken in response to hostile takeover bids. This resulted in a significant increase in the number and quality of independent directors on American boards as management attempted to insulate themselves from the serious threat of hostile takeovers.

In 2002, the Commercial Code was amended to allow Japanese companies to opt out of the traditional Japanese-style board featuring the statutory auditor and to adopt instead an American-style board with an “independent committee system.” Firms that opted for the American-style board were required to establish “independent” board committees for the audit, nomination, and compensation functions, which take the place of the statutory auditor. A key element of the American-style board is that it legally mandates a separation between directors and executive officers, which is synonymous in the

393. Gruener, supra note 168, at 873-74; Hines et al., supra note 22, at 408.
394. Gruener, supra note 168, at 873; Osugi, supra note 12.
395. According to the Ministry of Economy, Trade and Industry, by March 2006, 48 companies had introduced the poison pill out of Japan’s approximately 4000 listed companies. CORPORATE VALUE REPORT 2006, supra note 8, at 7, n. 7. There are reports that, by the end of 2007, slightly less than ten percent of listed companies had adopted the poison pill. Osugi, supra note 12, at 158. However, in the context of this paper, adoption of the pill after the end of the recent recovery (i.e., mid-2006) is irrelevant because it tells us nothing about the ex ante threat of hostile takeovers during or preceding the recent recovery—which is what this paper focuses on.
397. Gilson, supra note 1, at 33-34; MONKS & MINOW, supra note 384, at 227, 248.
398. Gilson, supra note 1, at 34.
399. In 1973, inside directors held thirty-eight percent of the seats on American boards. In 2004, the percentage of insiders on American boards dropped to twenty-five percent. MONKS & MINOW, supra note 384, at 227, 248; see also Gilson, supra note 1, at 33-34.
400. See Puchniak, supra note 47.
401. See id. at 49-56; Milhaupt, supra note 2, at 2187.
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traditional Japanese-style statutory auditor system.402

The combination of the separation between directors and executive officers and the increased independence of the committee system should have made American-style boards an attractive option for companies that felt threatened by hostile takeovers because it increased their ability to justify the adoption of takeover defenses. This was especially true after the release of the 2005 Takeover Guidelines, which transplanted Delaware takeover jurisprudence into Japan. Indeed, after the Takeover Guidelines were released, Milhaupt predicted “there could be a spike in adoptions of the U.S.-style board committee system” because the independent committees played a large role in Delaware takeover jurisprudence.403

Milhaupt’s prediction proved to be incorrect. In fact, the opposite has happened. Since 2002, less than three percent of Japan’s listed companies have chosen to adopt an American-style board.404 In addition, over three-quarters of the companies that have adopted an American-style board did so in 2003 (the year following the amendment).405 Thus, the number of companies that decided to adopt the American-style board was considerably lower after the Takeover Guidelines were implemented in 2005 than in 2002, after the amendment was first introduced.406 The fact that so few listed companies have chosen to adopt this change, especially after the Takeover Guidelines imported Delaware takeover jurisprudence, illustrates that the threat of hostile takeovers is not serious enough to influence the actions of the vast majority of Japanese managers.

The failure of Japanese companies to adopt quickly the poison pill and the American-style board is even more of a surprise, considering that 2005 witnessed a postwar low in cross-shareholding and a postwar high of foreign shareholding and shareholder activism. The most logical explanation for the failure of Japanese companies to implement quickly these defensive tactics is that managers did not perceive the threat of hostile takeovers as serious enough to take action. The flawed predictions of a rush to the poison pill and American-style boards should serve as a reminder that Japanese corporate governance cannot be understood based on United States' precedent—especially the American hostile takeovers environment of the 1980s.

402. See Milhaupt, supra note 2, at 2187; Puchniak, supra note 47, at 50, 55-56.
403. Milhaupt, supra note 2, at 2202.
404. As of 2006, 110 out of Japan’s approximately 4000 listed companies have adopted a U.S.-style board. Lawley, supra note 23, at 106; Osugi supra note 12, at 158.
405. Seventy-one companies moved to the committee-system in the first round of adoptions in 2003. As of October 2006, another thirty-nine companies have adopted the committee-system. Lawley, supra note 23.
406. Id.
V. THE LOST UTOPIA FOR HOSTILE TAKEOVERS

A. Signs that Japan's "Barriers" to Hostile Takeovers Are Rebuilding

As Japan has recently moved from restructuring to sustained growth, its "hostile takeovers utopia" has faded. With stock markets regaining their value, the number of companies with assets that far exceed their cumulative stock price has dropped. In fact, there are now reports that companies in Japan are starting to sell consistently at a premium. According to an analyst at Lehman Brothers in Tokyo, "you can't buy a dollar of assets for 60 cents anymore...now you need to pay a premium [because] deals are a growth play now."407

There are also reports that it is now difficult to find takeover targets among any of Japan's "blue chip" companies.409 This suggests that even if there is suddenly a boom in hostile takeovers, it will not be driven by the large-scale restructuring that characterized the United States in the 1980s.410 Rather, the purpose of takeovers will be an attempt to exploit synergies or to squeeze even more profit out of companies that have already been successfully restructured.

Another interesting phenomenon during the recent recovery has been a return to cross-shareholding.411 Since 2004, shares held by non-financial companies, which are commonly seen as cross-shareholdings, have rapidly expanded by over thirty percent.412 More recently, in the second half of 2006, the three mega-banks also increased their cross-shareholdings.413 The return to cross-shareholding, which occurred at the same time the Japanese economy was returning to economic normalcy, suggests that Japanese companies sold their cross-shareholdings during the lost decade out of a necessity to raise capital—not because they thought the main bank system or cross-shareholding was fundamentally flawed.414 It is also worth noting that the recent growth in cross-shareholding occurred despite the fact that the poison pill was "officially sanctioned" by the Japanese government. This calls into question the claim by Milhaupt and West that cross-shareholding existed in Japan because Japan's corporate law did not allow for American-style defenses—particularly the poison pill.415

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407. EUROMONEY Feb. 2007a, supra note 97.
408. Id.
409. See Michiyo Nakamoto, The Doors Creak Open to Foreign Capitalism Investment Has a Different Character and Private Equity Is at the Fore, FIN. TIMES, Mar. 13, 2007.
410. Holmstrom & Kaplan, supra note 2, at 129.
413. Id.
415. See Hines et al., supra note 22, at 374-75; Milhaupt, supra note 2, at 2173-74; Milhaupt & West, supra note 3, at 22, 47.
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As the recent recovery ended, reports of enthusiasm for hostile takeovers in corporate Japan also waned and even reversed course. In 2005, during Livedoor’s hostile takeover attempt, Horie, the founder and CEO of Livedoor, was perceived by a large portion of the Japanese public as the face of Japan’s rapidly evolving business culture. His hostile attempt to take over Fuji TV was viewed as evidence that American-style hostile takeovers had finally arrived in Japan. As explained above, even in the wake of Livedoor’s failure, many pundits erroneously viewed Horie’s mere attempt to challenge the Japanese old guard as a watershed moment marking the beginning of an era of hostile takeovers in Japan.

However, in the first quarter of 2006, all of this quickly changed when Horie was arrested and indicted on allegations of accounting fraud and stock market manipulation. The scandal spurred a massive two-day sell-off on the TSE. The volume of selling was so great that the TSE was forced to close early, a move that was seen as a “blow to the nation’s pride.” This caused markets around the world to fall and was dubbed by the news media as the “Livedoor shock.” Horie was disgraced, as Livedoor’s share price plummeted in a month from 696 yen to 61 yen and in April, the stock was delisted from the TSE.

The picture of Horie solemnly bowing before a trial judge in Tokyo, with his trademark spiky-hair fully cropped and wearing a conservative “salary man” black suit, was a stark contrast to the once renegade shareholder activist who was famous for flamboyantly challenging Japan’s conservative business culture. In March 2007, Horie was sentenced to two and a half years in prison. Given that Japanese courts rarely impose jail terms for securities violations, many viewed this sentence as extremely harsh.

Murakami, the CEO of MAC, who was the other de facto leader of shareholder activism in Japan during the recent recovery, was also recently disgraced by criminal charges. In June 2006, Murakami was arrested on allegations of insider trading that took place during the infamous Livedoor hostile takeover attempt. As Murakami awaited trial, most commentators

416. See Osugi, supra note 12, at 156-57; see also Alford, supra note 22; David Ibbison, Koizumi Drops FDI Pledge on M&A Fears, FIN. TIMES, Feb. 2, 2006; ECONOMIST Sept. 9, 2006, supra note 22.
417. Hines et al., supra note 22, at n.227.
418. Id. at 376-77; Gruener, supra note 168, at 873, 895; EIU 2005, supra note 15, at 7.  
419. See Caryl, supra note 208; Kingston, supra note 17; Nakamoto, supra note 175.
420. Osugi, supra note 12.
422. Alger, supra note 300, at 323.
423. Hines et al., supra note 22, at n.227.
426. Akihito Fukuda, Japanese Investors Face Stricter Disclosure Rules, INT’L HERALD TRIB.,
saw the case against him as weak but nevertheless expected that he may receive a harsh sentence to send a message to "all those wannabe [corporate raiders] to reassess their approach to the market." 427 As suspected, on July 19, 2007, Murakami received the harshest sentence for insider trading ever issued by a Japanese court. 428 During the sentencing, the judge called Murakami's "profit first attitude . . . horrifying." 429

The imprisonment and disgrace of Japan's two most prominent shareholder activists, who were widely viewed as the face of hostile takeovers in Japan, has caused a "chilling effect" in Japan's takeover market. 430 Combined with the decline in attractive takeover targets and the rise in cross-shareholding, these sentences serve as yet another caution for those who, for the last two decades, have been perpetually predicting the arrival of American-style hostile takeovers in Japan. 431 They further illustrate how Japan's unique form of corporate governance continues to persist and dominate. Perhaps, most importantly, the fact that Japan's restructuring is largely over and cross-shareholding is rapidly expanding suggests that even if hostile takeovers do become prevalent in the future they will likely occur in a much different environment, and serve a much different purpose, than those in the United States during the 1980s.

VI. THE LESSONS LEARNED FROM JAPAN'S FRIENDLY RECOVERY

A. Hostile Takeovers Are Unnecessary for Efficient Corporate Governance

The lesson from Japan's recent recovery is simple. Hostile takeovers are unnecessary for an efficient system of corporate governance. Japanese corporate governance proved this once during the postwar period by outperforming all other economies for over three decades without hostile takeovers. Now, Japanese corporate governance has proven it again in the era of post-globalization by successfully completing one of the most dramatic economic recoveries in modern history without hostile takeovers.

In addition, the idea that a system of corporate governance without hostile takeovers (i.e., "friendly efficiency") can successfully compete in the era of globalization has recently received empirical support. A recent study by the


427. Herman, supra note 22.
428. On July 19, 2007, Murakami was given a two-year prison sentence, without suspension, by the Tokyo District Court. In Japan, there has only been one other case in which an unsuspended prison sentence has been served for insider trading. The two-year sentence was also the longest ever issued for insider trading. In addition, Murakami received a 1.15 billion yen financial penalty and a 3 million yen criminal fine. Murakami has appealed the decision. See Murakami Gets 2-yr Term, DAILY YOMIURI, July 20, 2007.

429. See id.
430. Herman, supra note 22.
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Osaka Chamber of Commerce finds that while Japan's friendly M&A market is much smaller than other developed countries, it produces better results. Specifically, executives of post-merger companies in Japan are considerably more likely than executives in post-merger companies in other developed countries to report that the merger produced synergic gains and was ultimately a success.432

The considerably higher success rate of Japanese mergers may be attributed to the fact that Japan's friendly M&A market is based on mergers by agreement between all of the stakeholders—not the ever looming threat of hostile takeovers. While the hostile M&A markets around the world may produce lots of media headlines and large numbers, Japan's M&A market-based on friendly efficiency produces long-term results.433 This conclusion is further supported by Gilson's recent research in which he empirically demonstrates (based on the highly successful Swedish economy) that an economy driven almost exclusively by controlling shareholders, which by definition produces a friendly M&A market, can be just as efficient (if not more efficient) than the most successful dispersed shareholding, hostile takeovers-based, economies (i.e., the United States and the United Kingdom).434

The conclusion that hostile takeovers are not a necessary mechanism for efficient corporate governance will likely only surprise two groups: M&A pundits in Tokyo who perpetually hope for the arrival of American-style hostile takeovers in Japan and diehard supporters of the American model of corporate governance. Those scholars who pay attention to empirical research will likely find this conclusion somewhat mundane. After all, it is well known that there is no conclusive empirical evidence that hostile takeovers increase corporate efficiency.435 This is further buttressed by evidence that hostile takeovers played a diminished role in the United States during the 1990s—perhaps America's greatest period of economic prosperity.436

The conclusion, while evident to some, is nevertheless important because it demonstrates that Japanese corporate governance provides a viable alternative to the hostile takeovers-based American model. It also provides a response to the rapidly expanding group of corporate governance pundits who blindly accept hostile takeovers as a necessary mechanism for economic efficiency. In addition, this conclusion should give pause to the scores of academics and

432. Id. at 40. For further evidence of the efficiency of Japan's friendly M&A market, see ABEGGLLEN, supra note 5, at 163-64.
433. Id.
436. See Baird & Rasmussen, supra note 1, at 1244.
experts who have been erroneously predicting the arrival of American-style hostile takeovers in Japan for the last two decades. Hopefully, this conclusion will also cause experts to begin to root for "the efficiency of friendliness" over "hostile takeovers"—even if only because the former sounds so much nicer.